Supreme Court, U.S.

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In the Supreme Court of the United States

IN RE: WESTPOINTE L.P., a Missouri Partnership
d/b/a Westpointe Apartments

Northwest Village Limited Partnership,
Grandview Hills Limited Partnership,
Parkridge Apartments Limited Partnership,
Lamplite Limited Partnership,
Westpointe Limited Partnership,
Petitioners,

v.

William E. Franke, Gannon Management Company
of Missouri, and Prairie Properties, L.L.C.,
Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

This case presents a confirmed bankruptcy reorganization plan in which the reorganizer was a third party, not the debtor or a creditor. Over the objection of the Debtors, the entire estate is transferred to the third party reorganizer. Although some creditors were impaired, the plan pays 100 percent of allowed claims, but pays nothing to the debtor's equity interests which are terminated. Payments under the Plan are 100 percent funded with income from the estate, as the reorganizer contributes no new money or any other new value to the plan. The bankruptcy court confirmed the plan, finding that the estate was insolvent and that it was therefore fair and equitable to terminate the Debtors' equity interests.

1. Should "reorganization value" be calculated based on the fair market value of estate assets to generic outsiders or based on the value of the reorganized estate to the actual reorganizer? If the reorganized estate has value, is it an unconstitutional "taking" to terminate the debtor's equity interests without compensation to the interest holders.

2. When a mortgage holder has an under-secured claim, 11 U.S.C. §506(a) requires the claim to be separated into secured and unsecured portions. The mortgage claim in this case was non-recourse and the debtor was not retaining the collateral; therefore, the unsecured, non-recourse, deficiency claim could not be allowed. 11 U.S.C. §502(b)(1); 11 U.S.C. §1111(b)(1)(A). When making the insolvency calculation, was it error for the bankruptcy court to include the non-recourse deficiency claim as a liability of the estate?

3. 11 U.S.C. §1129 puts the burden of proof for confirmability of a reorganization plan on the plan proponent and affirmatively charges the bankruptcy court with an oversight duty to require adherence to the Bankruptcy Code. Must a party who objects to the plan be required to specifically point out each and every deficiency in order to preserve the same for appellate review? There is a split of the Circuit Courts on this issue.

LIST OF PARTIES

Petitioners

Northwest Village Limited Partnership, Granview Hills Limited Partnership, Parkridge Apartments Limited Partnership, Lamplite Limited Partnership, Westpointe Limited Partnership have no corporate affiliations.

Respondents

William E. Franke, Gannon Management Company of Missouri, and Prairie Properties, L.L.C.

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eighth Circuit in *In re: Westpointe, L.P.*, 241 F.3d 1005 (8th Cir. 2001), is set forth in the Appendix hereto (App. A). By order filed May 1, 2001, the Eighth Circuit denied the petition for rehearing and suggestion for rehearing *en banc* (App. B).

The opinion of the United States District Court for the Eastern District of Missouri in *In re: Westpointe, L.P.*, 234 B.R. 431 (E.D.Mo. 1999), is set forth in the Appendix hereto (App. C).

The Memorandum of Decision of the United States Bankruptcy Court for the Eastern District of Missouri in *In re Westpointe, L.P.* is unreported and set forth in the Appendix hereto (App. D).

JURISDICTION

The final judgment of the United States Court of Appeals for the Eighth Circuit affirming the decision of the District Court of the Eastern District of Missouri which upheld the decision of the Bankruptcy Court to confirm the Plan of Reorganization was entered on March 14, 2001. A timely Petition for Rehearing or Rehearing *En Banc* was filed and an order denying the same was entered on May 1, 2001. The time for filing this Petition for Writ of Certiorari was extended by order of Justice Clarence Thomas to August 13, 2001. 28 U.S.C. §2101(c).

The jurisdiction of this Court is invoked pursuant to the provisions of 28 U.S.C. §1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

United States Constitution, Amendment V

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

11 U.S.C. §502(b)(1)

(b) Except as provided in subsections (e)(2), (f), (g), (h) and (i) of this section, if such objection to a claim is made, the court, after notice and a hearing, shall determine the amount of such claim in lawful currency of the United States as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that--
(1) such claim is unenforceable against the debtor and property of the debtor, under any agreement or applicable law for a reason other than because such claim is contingent or unmatured.

11 U.S.C. §506 Determination of secured status

(a) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to set off is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(b) To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose.

(c) The trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim.

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless--

(1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or

(2) such claim is not an allowed secured claim due only to the failure of any entity to file a

proof of such claim under section 501 of this title.

11 U.S.C. §1111 Claims and interests

(b) (1) (A) A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse, unless

(i) the class of which such claim is a part elects, by at least two-thirds in amount and more than half in number of allowed claims of such class, application of paragraph (2) of this subsection; or

(ii) such holder does not have such recourse and such property is sold under section 363 of this title or is to be sold under the plan.

(B) A class of claims may not elect application of paragraph (2) of this subsection if--

(i) the interest on account of such claims of the holders of such claims in such property is of inconsequential value; or

(ii) the holder of a claim of such class has recourse against the debtor on account of such claim and such property is sold under section 363 of this title or is to be sold under the plan.

(2) If such an election is made, then notwithstanding section 506(a) of this title, such claim is a secured claim to the extent that such claim is allowed.

11 U.S.C. §1129 Confirmation of plan

(a) The court shall confirm a plan only if all of the following requirements are met:

(1) The plan complies with the applicable provisions of this title
(2) The proponent of the plan complies with the applicable provisions of this title
(3) The plan has been proposed in good faith and not by any means forbidden by law.
(4) Any payment made or to be made by the proponent. by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.
(5) (A) (i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and

(ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and
(B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.

(6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title on such date; or

(B) if section 1111(b)(2) of this title applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan an account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests–

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that-

(A) with respect to a claim of a kind specified in section 507(a)(1) or 507(a)(2) of this title, on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, each holder of a claim of such class will receive--

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim; and

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim.

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any inside.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for

further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.

(12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.

(13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title, at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title, at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.

(b) (1) Notwithstanding section 510(a) of this title, if all of the applicable requirements of subsection (a) of this section other than paragraph (8) are met with respect to a plan, the court, on request of the proponent of the plan, shall confirm the plan notwithstanding the requirements of such paragraph if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.

(2) For the purpose of this subsection, the condition that a plan be fair and equitable with respect to a class includes the following requirements:

(A) With respect to a class of secured

claims, the plan provides--

(i) (I) that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims; and

(II) that each holder of a claim of such class receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property;

(ii) for the sale, subject to section 363(k) of this title, of any property that is subject to the liens securing such claims, free and clear of such liens, with such liens to attach to the proceeds of such sale, and the treatment of such liens on proceeds under clause (i) or (iii) of this subparagraph; or

(iii) for the realization by such holders of the indubitable equivalent of such claims.

(B) With respect to a class of unsecured claims--

(i) the plan provides that each holder of a claim of such class receive or retain on account of such claim property of a value, as of the effective date of the plan, equal to the allowed amount of

such claim; or

(ii) the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan on account of such junior claim or interest any property.

(C) With respect to a class of interests--

(i) the plan provides that each holder of an interest of such class receive or retain on account of such interest property of a value, as of the effective date of the plan, equal to the greatest of the allowed amount of any fixed liquidation preference to which such holder is entitled, any fixed redemption price to which such holder is entitled, or the value of such interest; or

(ii) the holder of any interest that is junior to the interests of such class will not receive or retain under the plan on account of such junior interest any property.

(c) Notwithstanding subsections (a) and (b) of this section and except as provided in section 1127(b) of this title, the court may confirm only one plan, unless the order of confirmation in the case has been revoked under section 1144 of this title. If the requirements of subsections (a) and (b) of this section are met with respect to more than one plan, the court shall consider the preferences of creditors and equity security holders in determining which plan to confirm.

(d) Notwithstanding any other provision of this section, on request of a party in interest that is a governmental unit, the court may not confirm a plan if the principal purpose of the plan is the avoidance of taxes or the avoidance of the application of section 5 of the Securities Act of 1933. In any hearing under this subsection, the governmental unit has the burden of proof on the issue of avoidance.

STATEMENT OF THE CASE

This case involves a Chapter 11 bankruptcy in which a reorganization plan (the "Plan") was proposed by a third party and was confirmed over the objection of the Debtors. The bankruptcy estate consisted of, *inter alia*, five apartment projects with a fair market value of $38,600,000, accumulated rents of $9,377,390.61, funds in the amount of $302,702, which were returned to the Debtors when GNMA bonds secured by the first mortgage were paid off in full (the "Stabilization Funds"), and an adversary proceeding against the one of the plan proponents valued by the bankruptcy court at $4,510,000.

The properties were financed with a mortgage ($64,897,724) issued under §223(f) of the National Housing Act, 12 U.S.C. §§1701, *et seq.* (repealed 1990), pursuant to which the Department of Housing and Urban Development (HUD) would coinsure loans made by private lenders. The purpose of the coinsurance program was to make below-market mortgages available to preserve and modernize existing multi-family housing. App. C, 13a-14a.

The plan proponent (Franke-Gannon) was the manager of the apartment properties. In the Plan, an entity called GP19 (the "Reorganizer") was created to receive all the property of the estate, and to assume the non-recourse below-market mortgage from HUD. GP19 was 100% owned and controlled by non-creditors of the estate. Franke-Gannon projected that there would be substantial post-confirmation net profits for GP19, as well as an increasing equity interest as the mortgage was paid off over the life of the Plan. The present value of these cash flows and accumulation of equity was valued by the Debtors' at $7,711,402. App. D, 35a

The bankruptcy court, however, used a fair market valuation of the properties which assumed market mortgage terms and rates (not the HUD 223(f) terms and rates) and found that the unreorganized Debtors were balance sheet insolvent, and ruled that GP19 could, therefore, take over the estate and all cash flows from the estate, without compensation to the Debtors. Neither Franke-Gannon nor GP19 contributed anything for the post-confirmation rights that GP19 received under the Plan. The bankruptcy court relied on a fair market appraisal of the properties (the "Tellatin Appraisal") which assumed generic financing terms, but did not assume the specific financing terms of the 223(f) loan used by the Plan.

REASONS FOR GRANTING THE WRIT.

I. Confirmation of the Reorganization Plan was an Unconstitutional Taking of the Debtors' Equity Interests. In Affirming the Bankruptcy Court Decision, the Intermediate Courts Reinterpreted or Ignored This Court's Decision in *TMT Trailer Ferry* so as to Rob the Decision of any Continued Meaning in Chapter 11 Cases:

This case presents the Court with the opportunity to develop the bankruptcy doctrine of "reorganization value" as announced in, *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc.*, 390 U.S. 414, 88 S.Ct. 1157 (1968), to support the doctrine under the Fifth Amendment to the U.S. Constitution, to explain the relationship of the doctrine to the "new value" doctrine discussed in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 108 S.Ct. 963 (1988), and to provide the lower courts with clarity on these foundational reorganization issues.

If a plan of reorganization attempts to impair or extinguish the equity interests in the estate, the first consideration under the fair and equitable test of 11 U.S.C. §1129(b) is whether the estate as reorganized is solvent or insolvent. *TMT Trailer Ferry*, 390 U.S. at 441, 88 S.Ct. at 1172.

A successful debtor reorganization and maximization of the value of the estate are the primary purposes of Chapter 11, *N.L.R.B. v. Bilbisco & Bildisco*, 465 U.S. 513, 527, 104 S.Ct. 1188, 1196 (1984); *Tiobb v. Radloff*, 501 U.S. 157, 163, 111 S.Ct. 2197, 2201 (1991). "Under certain circumstances a ... debtor's estate will be worth more if reorganized under Chapter 11 than if liquidated under Chapter 7." *Tiobb*, 501 U.S. at 164, 111 S.Ct. at 2201.

In *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 202, 108 S.Ct. 963, 967 (1988), this Court discussed that if the estate is reorganized by the debtor, the debtor must pay in money or money's worth for the privilege of owning the reorganized estate if all claimants are not otherwise paid in full. This is true even if the bankruptcy estate is balance sheet insolvent. The reason for this is because there are always facts that are unique to the reorganizer, not shown on a typical balance sheet, that make the reorganized estate uniquely valuable to that reorganizer. In order to maximize the return to all claimants (including the interest holders), and thereby satisfy the fair and equitable rule, the reorganizer must give new value for the right to own the reorganized estate, even though the estate may have no balance sheet net worth.

In *TMT Trailer Ferry*, 390 U.S. at 444, 442, 88 S.Ct. at 1173, 1172 (1968), this Court said that if the estate is reorganized by a non-debtor that desires to terminate the

debtor's equity interests, even if the bankruptcy estate is balance sheet insolvent, the bankruptcy court must nevertheless "consider the value of the company once it [is] out of the reorganization proceedings", and that this valuation must embrace "all facts relevant to future earning capacity and hence to present worth." If post-reorganization company has a positive value, then the debtor's equity interests cannot be involuntarily terminated as part of the plan. "[W]hether a plan of reorganization excluding junior interests is fair and equitable depends upon the value of the reorganized company". *TMT Trailer Ferry*, 390 U.S. at 441, 88 S.Ct. at 1172. *Accord*, *In re P.J. Keating Company*, 168 B.R. 464, 468 (Bankr.D.Mass. 1994) (Reorganization value is the appropriate valuation methodology for equity cramdown plans and consists of the value of the debtor's assets as they exist after confirmation.); *In re Future Energy Corporation*, 83 B.R. 470, 500, 502 (Bankr.S.D.Ohio 1988) (In determining reorganization value, the court must consider "the future earnings of the reorganized debtor", and "the reduction of indebtedness which is effected by the Plan."); *In re Beaver Office Products, Inc.*, 185 B.R. 537, 543 (Bankr.N.D.Ohio 1995) ("A chapter 11 debtor's 'reorganization value' is based, in part, on the capitalized value of the chapter 11 debtor's future earnings.").

The Petitioners submit that *Ahlers* and *TMT Trailer Ferry* are saying the same thing, but in different contexts, *i.e.*, that it is the value of the reorganized estate to the "reorganizer" that must be valued. In *Ahlers* where the debtor is the reorganizer, the debtor must pay for this value in the form of new money. In *TMT Trailer Ferry* where a third party is the reorganizer, if the post-reorganization value is positive, then equity interests cannot be involuntarily terminated (or possibly must be bought out with a contribution of new money).

In this case there is an undisputed, substantial post-petition net income stream derived from the reorganized estate which the Reorganizer, GP19, gets to keep. This fact should not be ignored under the fair and equitable test when the interest of the equity holders is being canceled under the Plan. GP19 paid no money or equity for the right to this income stream. In contrast, the Debtors' equity interests had over $13,500,000 invested in the projects.

The bankruptcy court, however, refused to consider the post-confirmation net cash flows to GP19. App. D, 36a-37a. It also refused to consider that GP19 would put no money into the reorganized estate, yet would receive non-recourse government-subsidized financing over a 35-year term at 7%. *Id.* Instead it relied only on the Tellatin appraisal which used generic fair market assumptions ($9,650,000 in equity investment with 9% financing of the balance over a 25-year term with recourse) that were not true of the Franke-Gannon Plan. These assumptions were accurate for establishing fair market value under 11 U.S.C. §506(a), but created a false estimate of reorganization value. The courts below have frequently confused these two valuation methods.

The value and amount of the post-petition income stream to GP19 is very much affected by the amount of interest which GP19 must pay to produce this income stream. If the interest rate were 9% on a $60,000,000 loan, then there may be little or no net income which would flow to the reorganizer of the properties. If, however, the interest rate actually to be paid by the reorganizer is 7%, then the properties will cash flow and this cash flow has value to the reorganizer. The 2% margin on $60,000,000 makes a substantial difference in available annual cash flow.

In *TMT Trailer Ferry*, the reorganizer, like the Tellatin appraisal in the instant case, used a non-plan-specific income capitalization method for asserting its view of reorganization value:

> At the valuation hearings the trustee stated that his analysis of the financial structure and business of the debtor resulted in a going-concern value of $ 2,031,403.72. A valuation expert presented by the trustee estimated the going-concern value at between $1,607,692 and $1,800,000. He arrived at his conclusion by multiplying his estimate of the future earnings of the company by 7.7, a figure based on the assumption that earnings would be 13% of value. The valuation expert presented by the Committee concluded that estimated future earnings after taxes would be $ 327,500, and multiplying this by a price-earnings ratio of 13.8, arrived at the conclusion that TMT had a value of $4,519,500. The trial judge took an intermediate position. By projecting current earnings of the debtor for the first five months of 1962 over the remainder of the year, he concluded that pre-tax earnings would be $568,000. Reduced by estimated income taxes and capitalized at 10%, this yielded a going-concern value of $ 2,780,000. Since this figure fell well below the $ 5,477,370.05 of outstanding claims, he concluded <u>that the debtor was insolvent</u>. On this basis the plan was approved and confirmed.

TMT Trailer Ferry, 390 U.S. at 443, 88 S.Ct. at 1173.

This income capitalization approach is identical to the one used in the Tellatin fair market appraisal. This Court, however, threw out that approach because the future earnings calculation did not reflect the specific changed realities brought about by the reorganization plan as proposed by the reorganizer. These changed realities included, *inter alia*, refinancing the corporate debt. *TMT Trailer Ferry,* 390 U.S. at 425, 88 S.Ct. at 1164.

The District Court, however, interpreted *TMT Trailer Ferry* as only holding that future profits of a generic business with assets similar to that of the bankruptcy estate must be taken into account for calculation of reorganization value, and that the Tellatin fair market appraisal was therefore an appropriate measure of value. App. C, 26a. In the view of the District Court and the Eighth Circuit, there is no need to analyze the specific operational realities of the reorganized estate.

Upon close review of *TMT Trailer Ferry*, it is apparent that the error committed by the lower court was that, like the Tellatin appraisal, it relied exclusively on the generic external market conditions to determine value, and that it failed to take into account the specific internal operational changes brought about by the reorganization plan proposed by the reorganizer. "[T]he trial court steadfastly refused to consider the value of the company once it was out of the reorganization proceedings. In this, there was error." *Id.*, 390 U.S. at 444, 88 S.Ct. at 1173. This is precisely the same error made by the bankruptcy court below through its exclusive reliance on the Tellatin fair market appraisal.

The value of the estate to a hypothetical third party (the Tellatin appraisal) is "not of controlling importance". *TMT Trailer Ferry,* 390 U.S. at 443, 88 S.Ct. at 1173. The

reason for this is the "fair and equitable rule" of 11 U.S.C. §1129(b). Even if the estate is balance sheet insolvent, if the estate has unique value to the reorganizer, it is not fair and equitable for the court to allow a reorganizer to take over ownership of the estate without paying unpaid creditors and interest holders for that value. *In re SM 104 Ltd.*, 160 B.R. 202, 228-229 (Bankr.S.D. Fla. 1993).

The Eighth Circuit, however, echoing the bankruptcy court, commented that "the special financing terms [of the Plan] were not a market condition available to the Debtors", implying that these terms could not be used to establish "reorganization value" unless the Debtors' could prove that they could have qualified for the same terms as procured by GP19. App. A, 5a.

Contrary to the Circuit Court's opinion, in *TMT Trailer Ferry*, there is no requirement for the objecting debtor to make a showing that it had the same ability as the reorganizer to effectuate the internal changes contemplated in the plan. Rather, it is the value of the estate to the actual reorganizer of the estate that is relevant to reorganization valuation, irrespective of whether or not the Debtor could effectuate the same changes.

Put in an analogous way, if "X" owns a one-of-a-kind widget of no intrinsic value, but "Y" has a new invention that needs that widget, just because the widget has no intrinsic value, does not give Y the right to take the widget from X. If the Y wants the widget, X can sell it to him at a price that reflects the unique value of the widget to Y, even though the widget has no value to any other person in the world.

The same is true with the bankruptcy estate. If a reorganizer wants to own the estate, because the reorganizer

can uniquely obtain value from the reorganized estate, the reorganizer must pay for the equity interest, even if the estate does not show a balance sheet value as measured by general market conditions. Potential ownership of the equity position is still a thing of value.

As mentioned *supra*, this analysis fits hand-in-glove with the Court's pronouncements in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-8, 108 S.Ct. 963, 969 (1988), wherein the debtor sought to retain the insolvent equity interest in the estate without fully paying the creditors of the estate:

> Even where debts far exceed the current value of assets, a debtor who retains his equity interest in the enterprise retains "property." Whether the value is present or prospective, for dividends or only for purposes of control a retained equity interest is a property interest to which the creditors are entitled before the stockholders can retain it for any purpose whatsoever. ... Indeed, even in a sole proprietorship, where "going concern" value may be minimal, there may still be some value in the control of the enterprise; obviously, also at issue is the interest in potential future profits of a now-insolvent business. ... "Property" includes both tangible and intangible property.
>
> Even cursory consideration reveals that [the insolvent equity interest] might be "valuable" for one of several reasons. For example, ... respondents would be entitled to a share of any profits earned by the sale of secured property during the reorganization period - an interest

> which can hardly be considered "worthless." And there is great common sense in petitioners' contention that "obviously, there is some going concern value here, or the parties would not have been litigating over it for the last three years."

Ahlers, 485 U.S. at 207-8, 108 S.Ct. at 969.

All of these statements apply with equal force to the instant plan whereunder creditors are paid 100% of their allowed claims, but in which there is a forceful transfer of the debtor's equity interests to a third party. The insolvent equity interest is nonetheless a property interest entitled to constitutional protection. The bankruptcy court's confirmation of the Plan in this case amounts to a "taking" of this property interest without just compensation in contravention of the Fifth Amendment to the U.S. Constitution. As stated by this Court in *Phillips v. Washington Legal Foundation*, 524 U.S. 156, 118 S.Ct. 1925 (1998):

> We have never held that a physical item is not "property" simply because it lacks a positive economic or market value. ... [P]roperty is more than economic value; it also consists of the group of rights which the so-called owner exercises in his dominion of the physical thing, such as the right to possess, use and dispose of it.

Id., 524 U.S. at 169-170, 118 S.Ct. at 1933.

Thus, the involuntary termination of the Debtor's equity interests, when all other claims are paid in full, not

only violates the fair and equitable rule, but also is an unconstitutional "taking" without just compensation. At a minimum, ownership of the estate as reorganized under the Plan should have been offered via public sale so as to provide just compensation to the unpaid equity interests. *In re BMW Group I, Ltd.*, 168 B.R. 731 (Bankr.W.D.Ok. 1994); *Matter of Homestead Partners, LTD.*, 197 B.R. 706, 715-16 (Bankr.N.Ga. 1996). *See also*, *Bank of America Nat. Trust and Sav. Assn. v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 119 S.Ct. 1411 (1999).

On the other hand, if no person will pay any value for the reorganized estate, then the estate should simply be dismantled and sold under generic market conditions for cash to the highest bidder.

There has been much confusion in the courts below concerning the difference between a fair market valuation under §506(a) for the purpose of establishing the amount of a secured claim, verses a reorganization valuation for the purpose of establishing whether equity interests can be involuntarily terminated or establishing the amount of new value which a reorganizing debtor must contribute. This case presents an opportunity for this Court to provide definitive clarity on this issue, and for this reason the Court should issue its Writ of Certiorari to the Eighth Circuit Court of Appeals.

II. Under 11 U.S.C. §506(a) and §1129, the Solvency Calculation Necessary to Terminate Equity Interests Should Have Limited the Non-Recourse Secured Claim to the Value of the Security Interest:

This solvency valuation question is important for development of the "reorganization value" measure announced in *TMT Trailer Ferry*.

In this case, HUD held a non-recourse mortgage on the properties, and filed its proof of claim in the amount of $64,897,724, stating that "This is a secured claim except to the extent that the assets described in the attached loan documents are insufficient to satisfy the claim." The amount of the claim was not objected to by the Debtor's, but the Debtors did object to any determination that the HUD claim was fully secured.

The HUD loan was non-recourse, but under-secured by over $25 million. App. A, 6a. The Plan made no provision for a HUD unsecured deficiency claim, but provided for full payment of the $64,897,724 as a "secured" claim. Said payments greatly exceeded the fair market value of the properties.

When the bankruptcy court made its solvency calculation to determine if the equity interests could be terminated, it charged the full amount of the $64,897,724 claim as a liability despite the fact that the unsecured portion of the HUD claim was non-recourse, and that HUD had made no election under 11 U.S.C. §1111(b)(2). Being an unsecured, non-recourse claim, it was not an allowable claim and should not have been charged against the Debtors in the solvency calculation. Unsecured, non-recourse claims are not allowable claims because they are unenforceable against either the Debtors or the property of the Debtors. 11 U.S.C. §502(b)(1).

11 U.S.C. §506(a) requires the bankruptcy court to separate under-secured claims into secured and unsecured portions. In pertinent part, §506(a) states:

> An allowed claim of a creditor secured by a lien on property in which the estate has an

> interest ... is a secured claim to the extent of such creditor's interest ... in the property ..., and is an unsecured claim to the extent that the value of such creditor's interest ... is less than the amount of such allowed claim. Such value **shall be determined** ... in conjunction with any hearing ... on a plan affecting such creditor's interest.

HUD did not make an election under 11 U.S.C. §1111(b)(2) to override the application of 11 U.S.C. §506(a). App. A, 6a. Thus, application of §506(a) was mandatory on the court ("Such value **shall be determined** ... in conjunction with any hearing ... on a plan affecting such creditor's interest."). Nothing in the Bankruptcy Code authorizes a creditor's plan to override or ignore the mandate of §506(a). In fact, §§1129(a)(1)[1], (7)[2] and (b)[3] put the burden on the court to determine whether the plan complies with §506(a) before it can confirm the plan.

Because the HUD claim was non-recourse, application of §506(a) limits the HUD claim to the value of its collateral in the calculation of the Debtor's insolvency. The Eighth,

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[1] 11 U.S.C. §1129(a)(1) provides: "The plan complies with the applicable provisions of this title." "Applicable provisions of this title", of course, include §506(a) (The court shall determine the secured and unsecured portion of a claim) and §1122 ("A plan may place a claim ... in a particular class only if such claim ... is substantially similar to the other claims ... of such class").

[2] 11 U.S.C. §1129(a)(7) is the best interest of the creditors' test.

[3] 11 U.S.C. §1129(b) is the fair and equitable test.

Circuit, however, stated that under §1111(b)(1)(A), "loans of this sort receive recourse treatment even if they are contractually non-recourse." In this statement there is clear error. Under subsection (ii) of section 1111(b)(1)(A), the anti-nonrecourse provision does not apply if, under the plan, the debtor does not retain ownership of the collateral, as is true under this Plan. *In re Union Meeting Partners*, 160 B.R. 757, 769-770 (Bankr.E.D.Pa. 1993); *In re Western Real Estate Fund, Inc.*, 109 B.R. 455, 464-465 (Bankr.W.D.Ok. 1990); *In the Matter of DRW Property Co.*, 57 B.R. 987 (Bankr.N.D.Tex. 1986).

The Court should grant Certiorari on this issue to clarify the limitations of the anti-nonrecourse provisions of 11 U.S.C. 1111(b)(1), and to aid the analysis of "reorganization value" announced in *TMT Trailer Ferry*.

III. There is a Division Among the Circuits Regarding the Waivability of the Section 1129 Requirements for Confirmation of Plans of Reorganization:

11 U.S.C. §1129(a) states that "The court shall confirm a plan only if the following requirements are met". Many courts have interpreted this provision to mean that the requirements of §1129 are not waivable and that the bankruptcy judge has an affirmative duty to independently investigate and determine if all the requirements have been met, even if no objection has been raised. *See, In re Perez*, 30 F.3d 1209, 1213-14 (9th Cir. 1994); *In the Matter of Kermit Wayne Williams*, 850 F.2d 250, 253 (5thCir. 1988); *In the Matter of KDI Corporation*, 477 F.2d 742, 746 (6thCir. 1973); *In re Duval Manor Associates*, 203 B.R. 42, 45 (E.D. Pa. 1996) ("I find that it is ... required by the language of §1129 that the bankruptcy judge act as an 'inquisitor' when the subject of the inquiry is the compliance of the plan with

each of the specific requirements of §1129 of the Code. Objections need not have been raised where, as here, the judge had an independent duty to determine that these statutory requirements had been met."); *In re T-H New Orleans Limited Partnership*, 188 B.R. 799, 805 (E.D. La. 1995); *In re Landscaping Services, Inc.*, 39 B.R. 588, 590-591 (Bankr.E.D.N.C. 1984); *In re Economy Cast Stone Company*, 16 B.R. 647, 649 (Bankr.E.D. Va. 1981).

Contrary to the above cited precedent, but consistent with the Tenth Circuit in *In re Ruti-Sweetwater, Inc.*, 836 F.2d 1263 (10thCir. 1983),[4] the Eighth Circuit ruled in this case that the bankruptcy court could properly confirm the Plan even if it did not comply with §506(a) in its treatment of the HUD claim, because the Debtors had failed to specifically object to the Plan's failure to separately classify the secured and unsecured portions of the HUD claim.[5] App. A, 6a-7a.

Petitioners assert that the *Perez* case from the Ninth Circuit more properly interprets §1129 of the Bankruptcy Code. Therein, the appellant had objected to the plan, but had

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[4] The *Ruti-Sweetwater* case has been roundly criticized, *see, e.g.*, 5 Collier on Bankruptcy, P1129.03[8] n. 125, 15th ed. revised, ("An unfortunate decision was rendered by the Court of Appeals for the Tenth Circuit which can have the effect, if followed, of setting the law on its ear.")

[5] The Eighth Circuit apparently overruled its previous decision in *United Properties Inc., v. Emporium Dept. Stores, Inc.*, 379 F.2d 55, 60-61 (8thCir. 1967)(The bankruptcy court has an obligation "to make an informed and independent judgment as to whether the Plan was in the best interest of creditors and was feasible. This responsibility existed even though no objections were filed by the creditors.").

failed to raise the issue of the absolute priority rule in his objection. The court, however, found that because the bankruptcy court has an independent duty to determine whether the plan is in compliance with the Bankruptcy Code, normal waiver rules are not to be applied to cram-down proceedings.

> [B]ankruptcy proceedings are not precisely analogous to normal adversary litigation. The principal reason we require parties to raise an issue in the trial court is to give that court an opportunity to resolve the matter and, hopefully, avoid error. Also, when matters are first raised in the trial court, it's possible to develop the record as needed to present the issue properly on appeal. In normal adversarial litigation, neither the trial judge nor opposing counsel have the responsibility to raise issues a party fails to raise; if the affected party fails to object, the issue never comes before the court. The matter is different in bankruptcy proceedings where debtors-in-possession and trustees have a responsibility to raise certain issues, and the court itself must pass on those issues, whether or not they're specifically put in dispute. ... [W]hether there has been a proper cram-down after an entire class of creditors has objected is a central legal issue that can generally be resolved on the record as presented.

Perez, 30 F.3d at 1213-1214.

In the instant case the Petitioners objected to the Plan on numerous grounds, objected to the alleged security interest

which HUD claimed in several of the estate assets, but did not specifically raise the §506(a) requirement to bifurcate the HUD claim until the valuation hearing which took place after confirmation of the Plan. [6] The Eight Circuit held that failure to raise this specific objection at confirmation caused the issue to be waived. The outcome, however, would have been different under the Ninth Circuit's ruling in *Perez*. This difference has a fundamental impact on the way that confirmation hearings are conducted and on the appellate rights that flow therefrom.

Petitioners assert that Congress placed an independent duty on the bankruptcy court in §1129 to order achieve the *Perez* result, not the result in the instant case. The public policy behind this is a recognition that many creditors and interest holders are small involuntary participants in an extraordinarily complex process wherein their rights and best interests would often be trammeled by large creditors and interested parties absent the court's traditional independent duty to review proposed plans for fair and equitable treatment. If bankruptcy courts are not held accountable to perform this role, then the Congressional intent expressed in §1129 will be thwarted.

Thus, the Debtors respectfully petition the Court to issue its Writ of Certiorari to settle the differences among the

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[6] At the time of confirmation, the Plan Proponent (Franke-Gannon) did not assert or put on proof of the §506(a) value of the collateral. It was not until several years later after remand from the District Court that Franke-Gannon introduced evidence at the valuation hearing that the properties were worth only $38,600,000. Only at that time did it become an issue that the allowable HUD secured claim was substantially less than what the Plan proposed to pay.

Circuits regarding the waivability of the requirements of 11 U.S.C. §1129 for confirmation of plans of reorganization.

CONCLUSION

For all the reasons identified herein, a writ of certiorari should issue to review the decision of the United States Court of Appeals for the Eighth Circuit and, ultimately, to vacate and reverse the bankruptcy court order confirming the Plan and remand the matter to the bankruptcy court for further proceedings.

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APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[March 14, 2001, Filed]

No. 99-2705

IN RE: WESTPOINTE, L.P.,	)
A MISSOURI PARTNERSHIP,	)
DBA WESTPOINTE APARTMENTS,	)
Debtor	)
	)
NORTHWEST VILLAGE LIMITED	)
PARTNERSHIP; GRANDVIEW	)
HILLS LIMITED PARTNERSHIP;	)
PARKRIDGE APARTMENTS	)
LIMITED PARTNERSHIP;	)
LAMPLITE LIMITED PARTNERSHIP;	)
WESTPOINTE LIMITED PARTNERSHIP	)
Debtors-Appellants,	)
	)
v.	)
	)
WILLIAM E. FRANKE;	)
GANNON MANAGEMENT	)
COMPANY OF MISSOURI;	)
PRAIRIE PROPERTIES, L.L.C.;,	)
Creditors-Appellees.	)

NORTHWEST VILLAGE LIMITED PARTNERSHIP; GRANDVIEW HILLS LIMITED PARTNERSHIP; PARKRIDGE APARTMENTS LIMITED PARTNERSHIP; LAMPLITE LIMITED PARTNERSHIP; WESTPOINTE LIMITED PARTNERSHIP

Debtors-Appellants,

v.

PRAIRIE PROPERTIES, L.L.C.,

Creditor - Appellee

CYNTHIA MCNEILL,

Interested Party-Appellee.

SUSMAN, SCHERMER, RIMMEL & SHIFRIN,

Movant-Appellee

WILLIAM E. FRANKE; GANNON MANAGEMENT COMPANY OF MISSOURI;

Creditor-Appellee

Appeal from the United States District Court for the Eastern District of Missouri

OPINION

HANSEN, Circuit Judge.

In short,[1] five real estate limited partnerships ("Debtors") filed for Chapter 11 bankruptcy in September of 1990 after defaulting on their HUD mortgage. A reorganization plan was proposed by appellees William E. Franke and Gannon Management Company of Missouri ("Franke-Gannon"), approved by HUD, and later adopted by the bankruptcy court on June 22, 1992. As of that date, the bankruptcy court determined that the Debtors' estate had assets worth approximately $56.4 million and liabilities worth approximately $75.8 million. The Franke-Gannon reorganization plan was approved over the objection of the Debtors. Debtors appealed, arguing that the bankruptcy court erred in its valuation findings. The district court[2] upheld the bankruptcy court's approval of the Franke-Gannon plan, finding that the estate indeed was insolvent and thus the Debtors' equity interests in the estate were without value and were properly extinguished. Debtors appeal the district court's decision, arguing that the estate's assets actually exceeded its liabilities at the time of the reorganization and

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[1] We do not think it necessary to explain in detail the underlying facts and complicated procedural history of this case because those facts are set forth thoroughly in the district court's opinion. *See In re Westpointe*, L.P., 234 B.R. 431, 433-37 (E.D. Mo. 1999).

[2] The Honorable Stephen N. Limbaugh, United States District Judge for the Eastern District of Missouri.

that they are entitled to the excess value of the estate because the creditors have otherwise been paid in full. We affirm.

Our standard of review is the same as that of the district court, which reviewed the bankruptcy court's factual findings for clear error and its legal conclusions de novo. *See In re Mathiason*, 16 F.3d 234, 235 (8th Cir. 1994). A reorganization plan may be confirmed over the objection of equity holders whose interests are being eliminated as long as the "cramdown" requirements of 11 U.S.C. § 1129 are met, and specifically in this case the requirement in § 1129(b) that the plan be "fair and equitable" to any dissenting class. According to § 1129(b)(2)(C)(ii), a plan is fair and equitable as long as the holder of any interest junior to the dissenting impaired class does not receive any property under the reorganization plan, and because there are no interests junior to the Debtors, the confirmed plan satisfies this requirement. The other primary consideration for determining whether a plan which extinguishes equity interests is fair and equitable is whether the debtor is solvent. *See In re Koelbl*, 751 F.2d 137, 140 (2d Cir. 1984) ("The 'fair and equitable' requirement [of § 1129(b)] does not look toward protection of debtor interests, but rather toward protection of dissenting creditor interests, absent the value of the ongoing business being large enough to support protection of the debtors."); *Moulded Prod., Inc. v. Barry*, 474 F.2d 220, 225 (8th Cir.) (explaining that if a business entity is insolvent the shareholders may not be allowed to participate in the reorganized entity even if they will lose their original investment), cert. denied, 412 U.S. 940, 37 L. Ed. 2d 400, 93 S. Ct. 2779 (1973). Thus, the main issue in this appeal is whether the bankruptcy court's finding that the Debtors' estate was insolvent is clearly erroneous.

Debtors argue that the bankruptcy court used an erroneous valuation method which underestimated the value of the estate's assets. We disagree. The bankruptcy court principally relied upon the *Tellatin* Appraisal for purposes of making its valuation determination. The *Tellatin* Appraisal, which was compiled by a recognized expert according to accepted professional standards, used an accepted valuation method--income capitalization--that incorporated anticipated future profits and the anticipated reversion value of the apartments into the final present going concern value of the estate. *See Moulded Products*, 474 F.2d at 225 (holding that the proper measure of valuation in reorganization proceedings is the going concern value of the debtors' estate and that a debtor is insolvent if the "aggregate amount of its property, as measured by its going concern value, is insufficient to pay its debts"). Cf. *In re King Resources Co.*, 651 F.2d 1326, 1335-36 (10th Cir. 1980) (finding capitalization of future earnings approach to valuation proper). We reject Debtors' contention that the failure of the *Tellatin* Appraisal to take into account the special financing terms of the Franke-Gannon reorganization plan was erroneous. The bankruptcy court did not abuse its discretion in refusing to qualify Debtors' valuation witness Randolph as an expert or in rejecting as not relevant to valuation Randolph's testimony; the special financing terms were not a market condition available to the Debtors, and in any event the market financing assumption behind the *Tellatin* Appraisal was adequate for purposes of determining solvency of the estate. In sum, we agree with the district court that the income capitalization method of valuation used in the *Tellatin* Appraisal and relied upon by the bankruptcy court was neither inappropriate as a matter of law nor was its final valuation determination as adopted by the bankruptcy court clearly erroneous.

Debtors also argue that the bankruptcy court overestimated the liabilities of the estate by miscalculating HUD's claim, and that the Debtors are entitled to the leftover funds because all creditors have been paid in full under the confirmed reorganization plan. Specifically, Debtors argue that HUD's secured interest in the properties was limited to the fair market value of the properties ($ 38.6 million) rather than the amount due on the loans ($ 64.9 million); that HUD did not have valid claims for the post-default rents ($9.4 million), the money wrongfully disbursed to Franke ($4.5 million), the money in the Bond Stabilization Fund ($ 330,000), or the two tax refunds ($ 280,000); and that HUD is improperly receiving over one hundred percent of its secured claim by its entitlement to twenty-five percent of any surplus cash and sale proceeds from the properties.

First, the full $64.9 million due on the HUD loans was correctly considered a liability of the estate. During the bankruptcy proceedings below, HUD filed a valid proof of claim for the full $64.9 million, no objections were raised by the Debtors, and the bankruptcy court proceeded to treat the entire amount as one allowed claim. It is true that the HUD loans were non-recourse and were under-secured by over $ 25 million given that the fair market value of the collateral (the apartment buildings) pledged as security for the loans was only $38.6 million. But under 11 U.S.C. § 1111 (a), loans of this sort receive recourse treatment even if they are contractually non-recourse. We reject Debtors' argument that HUD's failure to make an election under § 1111(b) precludes treating the unsecured portion of HUD's claim the same as the secured portion of the claim, because the Franke-Gannon plan clearly treated the two claims as part of the same class of interests and the Debtors failed to raise a proper and timely

objection. We therefore hold that HUD's entire $64.9 million claim was properly considered a liability against the Debtors' estate for purposes of determining insolvency and confirming the Franke-Gannon reorganization plan.

Second, we reject the Debtors' contention that they are entitled to the value of the post-default rents, the stabilization funds, and the tax refunds. We agree with the courts below that these funds are encumbered by HUD's liens and perfected security interests, but even if they are not, any error regarding HUD's entitlement (and Debtors' lack thereof) is harmless because the total amount of the funds is less than the $ 18 million shortfall of the estate as determined at valuation. For similar reasons, in addition to the failure of the Debtors to raise a proper objection below, we also reject Debtors argument that they are entitled to the value of the Franke claim.

Third, we reject the Debtors contention that HUD impermissibly received greater than one hundred percent of its claim. The Debtors not only failed to object to confirmation of the plan on this basis, which means we would have to address the issue for the first time on appeal, but we are also not convinced that the present value of HUD's entitlement to twenty-five percent of any surplus cash and any net sale or refinancing proceeds of the properties clearly amounts to HUD receiving greater than one hundred percent of its claim. The present value of this entitlement would have to be reduced to account for the time value of money, the twenty-five percent stake appears to be in return for the reduced loan interest rate agreed to by HUD in the reorganization plan, and the Debtors even argued at the valuation hearing that the present value of all the payments to

HUD (including the twenty-five percent stake) aggregated $ 58.3 million which is still less than HUD's $64.9 million claim. In short, this is a factual dispute between the parties reviewed for clear error, and the confirmed reorganization plan does not clearly and erroneously grant to HUD payments exceeding one hundred percent of its rightful claim.

Finally, we reject the remaining arguments of the Debtors because they are without merit or they were not raised properly in the courts below.

Based on the foregoing reasons, we affirm the district court's judgment upholding the bankruptcy court's decision accepting the proposed reorganization plan for the properties. The motions to dismiss Debtors' appeal based on equitable mootness and for lack of standing are dismissed as moot.

APPENDIX B

IN THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

[May 1, 2001, Decided]

No. 99-2705

IN RE: WESTPOINTE, L.P., A MISSOURI PARTNERSHIP, DBA WESTPOINTE APARTMENTS,
Debtor

NORTHWEST VILLAGE LIMITED PARTNERSHIP; GRANDVIEW HILLS LIMITED PARTNERSHIP; PARKRIDGE APARTMENTS LIMITED PARTNERSHIP; LAMPLITE LIMITED PARTNERSHIP; WESTPOINTE LIMITED PARTNERSHIP
Debtors-Appellants,

v.

WILLIAM E. FRANKE; GANNON MANAGEMENT COMPANY OF MISSOURI; PRAIRIE PROPERTIES, L.L.C.;,
Creditors-Appellees.

NORTHWEST VILLAGE LIMITED PARTNERSHIP; GRANDVIEW HILLS LIMITED PARTNERSHIP; PARKRIDGE APARTMENTS LIMITED PARTNERSHIP; LAMPLITE LIMITED PARTNERSHIP; WESTPOINTE LIMITED PARTNERSHIP	)
Debtors-Appellants,	)
v	)
PRAIRIE PROPERTIES, L.L.C.,	)
Creditor - Appellee	)
CYNTHIA MCNEILL,	)
Interested Party-Appellee.	)
SUSMAN, SCHERMER, RIMMEL & SHIFRIN,	)
Movant-Appellee	)
WILLIAM E. FRANKE; GANNON MANAGEMENT COMPANY OF MISSOURI;	)
Creditor-Appellee	)

Appeal from the United States District Court for the Eastern District of Missouri.

OPINION

The petition for rehearing en banc is denied. The petition for rehearing by the panel is also denied.

APPENDIX C

UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF MISSOURI EASTERN DIVISION

[May 26, 1999, Filed]

No. 4:92CV1381-SNL

IN RE: WESTPOINTE, L.P., a Missouri Partnership d/b/a Westpointe Apartments; Northwest Village Limited Partnership, Grandview Hills Limited Partnership, Parkridge Apartments Limited Partnership, Lamplite Limited Partnership and Westpointe Limited Partnership, *Appellants,*	)
vs.	)
William E. Franke, Gannon Management Company of Missouri, Prairie Properties L.L.C., and James S. Cole, Office of the U.S. Trustee, Appellees, Northwest Village Limited Partnership, Grandview Hills Limited Partnership, Parkridge Apartments Limited Partnership, Lamplite Limited Partnership and Westpointe Limited	)

Partnership,
Appellants,

vs.

Prairie Properties, L.L.C., Cynthia J. McNeill, James S. Cole, Office of the U.S. Trustee, and Susman, Shermer, Rimmel and Shifrin,
Appellees,

William E. Franke, Gannon Management Company of Missouri,
Cross-Appellants,

vs.

Northwest Village Limited Partnership, Grandview Hills Limited Partnership, Parkridge Apartments Limited Partnership, Lamplite Limited Partnership and Westpointe Limited Partnership,
Cross-Appellees,

JUDGES:

Stephen N. Limbaugh,
UNITED STATES DISTRICT JUDGE.

OPINION BY:

Stephen N. Limbaugh

MEMORANDUM OPINION

This matter is before the Court on cross-appeals from orders of the Bankruptcy Court confirming a Chapter 11 reorganization plan and valuating the bankruptcy estates. The action has a long and complex history. The action commenced on September 7, 1990, with the filing by five limited partnerships, each of which owned an apartment complex, of petitions for voluntary bankruptcy under 11 U.S.C. § 1129, after the partnerships defaulted on HUD mortgages. Each partnership consisted of two general partners - Pentad Properties, Inc., and Kevin Kelly - each with a 1/2% share, and one limited partner - St. Louis Associates, Ltd. (SLA), a limited partnership.

The properties were previously owned by William E. Franke, who purchased them in 1983 for approximately $ 38,000,000. In 1984 Franke sold the properties to SLA for approximately $57,300,000. Kelly was a general partner of SLA. This purchase was financed, in part, through SLA's execution of a promissory note in favor of Franke in the amount of $57,300,000, secured by a second mortgage in the properties.[1] SLA entered into a contract with the Gannon Management Corp. (GMC), owned by Franke, to manage the properties.

In 1988-89 the properties were refinanced under § 223(f) of the National Housing Act, 12 U.S.C. §§ 1701, et seq. (repealed 1990), pursuant to which the Department of

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[1] In 1986, Franke assigned the note and deed of trust to Mercantile Bank as security for a prior indebtedness to that bank.

Housing and Urban Development (HUD) would coinsure loans made by private lenders. The purpose of the coinsurance program was to make below-market mortgages available to preserve and modernize existing multi-family housing. The Act required that each property be owned by a single entity. Accordingly, the Debtor partnerships were formed and SLA sold one of the properties to each of these partnerships.

Carnegie Evans Corp. was the private lender and coinsurer of the refinancing and refinanced the properties for a total of approximately $62,500,00, with approximately $ 14,000,000 of the loan proceeds set aside in "non-operating" escrow funds for repairs, operating deficits, and additional collateral to secure the lender against uninsured losses. The refinancing deeds of trust were given first priority lien status against the properties. The security agreements granted Carnegie Evans a security interest in "all property . . . which is owned by the Debtor or becomes the property of the Debtor hereafter [including] all . . . cash; bank accounts; . . . rents; rights (if any) to amounts held in escrow; . . . judgments; liens and cause of action." (Gannon/Franke valuation hearing Exh. 46.)

Carnegie Evans raised money for the loans through the mortgage-backed securities program of the National Housing Act, § 1721(g), by selling Government National Mortgage Association (GNMA) certificates to Boatman's Bank in Boatman's capacity as Trustee for the Industrial Development Authority Trust of St. Louis County. Boatman's, in turn, raised funds for the certificates through the sale of industrial bonds. As a condition of obtaining a letter of credit from another bank as collateral for the bonds, a Bond Stabilization

Fund was set up with a percentage of the monies from the sale of the GNMA certificates. If the bonds were paid off, money remaining in the Stabilization Fund was to be disbursed to Debtors.

Immediately after the closings, Carnegie Evans endorsed the notes and assigned the deeds of trust and security agreements to GNMA. Carnegie Evans was designated as the servicer of the loans, and Debtors contracted with GMC to continue managing the properties. In April 1990 Debtors did not make the scheduled debt service payment to GNMA. GNMA declared the loans in default and assigned them to HUD, and Debtors initiated this action for bankruptcy. The unpaid balance on the HUD mortgages totaled approximately $65,000,000; the amount owed on the SLA note in favor of Franke was approximately $9,000,000. HUD, Franke and GMC filed proofs of claims against the estate.

Debtors filed adversary proceedings in the Bankruptcy Court against Gannon/Franke and against HUD and Carnegie Evans. The gravamen of the adversary proceedings was that escrow funds were wrongfully disbursed by Carnegie Evans for the personal use and benefit of Franke, and that HUD knew, but failed to inform Debtors, of mismanagement of the loans by Carnegie Evans. Debtors sought to have the transfers to Franke set aside as fraudulent or preferential. They claimed that the dissipation of the escrow funds led to Debtors' default, thus entitling them to be excused of the default, to the turnover of assets, and/or to reformation of some of the loan documents.

After the filing of the bankruptcy petitions, GNMA

paid off the GNMA certificates to Boatman's Bank, and Boatman's Bank used these proceeds to pay off the bonds. The $330,702 in the Bond Stabilization Fund was transferred to Debtors.

Debtors and Gannon/Franke filed different reorganization plans, with HUD accepting the Gannon/Franke plan. The Gannon/Franke plan, as amended and modified, divided claims and interests into eleven Classes - seven of these would be unimpaired while four would be impaired. The bankruptcy estate [2] was to be conveyed from Debtors to Gannon Partnership 19 (GP 19), a new entity to be formed with Franke as the managing general partner, and his children and various officers of GMC as limited partners. GP 19 would assume payment of the outstanding balance and interest of the HUD notes, and Franke would pay HUD, listed in the plan as an impaired creditor, an additional $4,510,000. HUD contended Franke owed HUD this money because it was disbursed to him by Carnegie Evans from the escrow funds in violation of HUD regulations. These monies were the same disbursements challenged in Debtors' adversary proceeding against Franke. The plan further provided that after payment of the $4,510,000, HUD would receive an additional "contingent interest" - 25% of net proceeds from any sale or refinancing of any of the properties. Several Classes - holders of allowed secured and unsecured claims - were to be paid in full by GP 19. Class 11, the holders of partnership interests in Debtors, was an "impaired class" which would receive no distribution.

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[2] For clarity, the singular 'estate' is used by the parties and the Courts.

On June 22, 1992, following an evidentiary hearing, the Bankruptcy Court confirmed the Gannon/Franke plan. The Court found that the plan was feasible and had been proposed in good faith, with no evidence of any side agreements between the Gannon/Franke and any creditors. The Court also found that each holder of an interest that did not accept the plan would receive under the plan no less than such holder would receive if Debtors were liquidated under Chapter 7 of the Bankruptcy Code, and that the plan did not discriminate unfairly against, and was fair and equitable with respect to, Class 11.

Debtors appealed confirmation of this plan; their motions for a stay pending appeal were denied. On appeal, Debtors' main argument was that the plan was not "fair and equitable" to the dissenting Class 11 interest-holders, as required by 11 U.S.C. § 1129(a) and(b), for "cram down" plans - that is, plans confirmed over the objections of an impaired class. Debtors argued that it was unfair for HUD to get full payment on its debt plus a share of potential future profits from the properties, and for GP 19 to acquire the properties at no risk of liability, while all of Debtors' interests in the properties were extinguished.

On February 10, 1993, the Bankruptcy Court entered an order in the HUD adversary proceedings, holding that Debtors had an interest in the escrow funds, but that in light of confirmation of the plan, the interest was valued at zero and the remaining aspects of the proceedings were moot.

In considering Debtors' appeal this Court concluded, by order dated August 31, 1994, that it could not be determined whether the confirmed plan was fair and equitable

because there was no evidence nor findings as to the value of the real property and cash assets of the estate. The Court believed that the solvency of the estate was an important issue given that the "going concern" of the estate had been assumed by a new entity which had no prior interest in the estate. The Court, accordingly, remanded the case to the Bankruptcy Court for a valuation of the bankruptcy estate as of June 22, 1992.

The Bankruptcy Court held a valuation hearing on September 9-12, 1996. Numerous witnesses provided oral testimony, and hundreds of documents were admitted into evidence. The parties stipulated to $51,553,968.21 in pre-confirmation assets of the estate. This included the fair market value of the properties valued at $38,600,000. The total of the pre-confirmation liabilities stipulated to was $1,154,958.75. Debtors and the proponents of the confirmed plan disagreed as to the "going concern" or "reorganization value" of the properties, the value of the adversary proceedings, and the amounts of HUD's and Franke's secured claims.

The Bankruptcy Court excluded the testimony of Debtors' valuation expert witness who had been designated to testify about future cash flows and other assets of the estate as reorganized in the possession of GP 19 under the Gannon/Franke plan. The Court stated that the hearing was to be limited to "a determination of the estate's value as of the date of confirmation of the plan." This expert would have testified that the value as of July 1992 of "the economic benefit to be derived from the debtor's properties by the ownership entity over a 38 year period of ownership [the period until the loan is paid off]" was $7,711,402. This amount consisted of three components: the portion of cash

flow attributable to the ownership entity; the residual value of the property at the end of the mortgage term; and the managing fee. (Debtor's valuation hearing Exh. 97.)

The Bankruptcy Court issued its valuation order on December 18, 1997. The Court reiterated its position that its role on remand was limited to determining what the value of the estates was prior to confirmation of the plan.. The Court reviewed the appraisals of the properties which resulted in the stipulation that their "fair market value" as of June 22, 1992, was $38,600,000. The appraiser used three methods of appraising the properties: (1) the Cost Approach which is based on the current cost of reproducing the buildings, minus depreciation, plus the cost of the land; (2) the Direct Sales Comparison Approach which compares the subject property to recent sales of similar complexes in the area, closely examining differences in location, physical qualities and financing factors; and (3) the Income Capitalization Approach which measures the present worth of "anticipated future net operating income." Under the third approach, the projected revenue for each property is developed by analyzing historic revenues, current contract rents, and comparable apartment complexes. (Appellees' valuation hearing Exh. 8 at 56.)

The appraised value of the properties as of June 22, 1992, was between $37,180,000, and $40,850,000, under the Income Capitalization Approach. The Bankruptcy Court found that the $38,600,000 figure, stipulated to by the parties, was supported by the record, and that this represented the relevant value of the properties to the estate. The Court concluded that this amount included items such as the projected future cash flow from the properties, upon which Debtors based their definition of "reorganization value."

The Bankruptcy Court concluded that because the loans were made under the National Housing Act, HUD had a perfected security interest in all property of Debtors, including post-petition rents, the $330,702 disbursed to Debtors from the Bond Stabilization Fund, and the adversary proceedings; and that these assets were, thus, not available to Debtors to fund their proposed reorganization plan. The Bankruptcy Court made the following additional valuation findings:

> (1) The pre-confirmation value of the HUD adversary proceedings was zero.
>
> (2) The pre-confirmation value to the estate of the Gannon/Franke adversary proceedings was $ 4,510,000. The Court ascertained this value by reference to the settlement noted above calling for Franke to repay HUD this amount for the challenged disbursements from Carnegie Evans to Franke.
>
> (3) HUD, Franke and GMC filed timely proofs of claims, in the amounts of $64,897,724, $9,290,192.25 and $486,456.24, respectively (totaling $74,674,372.49), which were liabilities of the estate.

In sum, the Bankruptcy Court concluded that on the relevant date, the estate's assets were $56,394,669.77,[3] and their liabilities were $75,829,331.24.[4] This appeal followed. Debtors renew their argument that the plan confirmed by the Bankruptcy Court was not fair and equitable. They argue that the Bankruptcy Court erred in several valuation matters and that, in actuality, the estate was solvent, so that extinguishing their equity interests while affording HUD and GP 19 "windfalls," rendered the plan unconfirmable.

Debtors' main argument is that the Bankruptcy Court erred in considering the pre-confirmation value of the properties, and not the "reorganization value." They argue that the fair market value appraisal did not take into account the favorable financing conditions under the Gannon/Franke plan, so that the value of the properties to a third-party purchaser would be considerably less than the "reorganization value" to GP 19 or Debtors.

Debtors next argue that the confirmed plan is not fair and equitable because it pays HUD more than 100% of its secured claim, in that in addition to repayment of the loans, HUD would be entitled to 25% of the proceeds from a sale.

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[3] The Bankruptcy court erred by $.44 in noting the stipulated assets as $51,553,967.77 (rather than the correct amount of $51,553,968.21). The amount as stated by the Court + $4,510.000.00 (Franke adversary proceedings) + $330,702.00 (Bond Stabilization Fund) = $56,394,669.77.

[4] The $74,674,372.49 in liabilities found by the Bankruptcy Court + the $1,154,958.75 in stipulated liabilities = $75,829,331.24.

They also assert that HUD's secured claim was actually in the amount of $38,600,000 - the fair market value of the properties, and not $64,897,724 - the amount due on the loans.

Debtors also challenge the Bankruptcy Court's findings that HUD had a lien on the post-petition rents from the properties ($9,377,390.61), on the monies from the Bond Stabilization Fund, on two tax refunds ($278,434.84), and on the $4,510,000 wrongfully disbursed to Franke. They argue that the Bankruptcy Court erred in allowing the Franke claim against the estate because the confirmation plan itself disallows this claim, because Franke's proof of claim was defective, and because the collateral was "fully encumbered by the first pledge to HUD." Accordingly, Debtors argue, this claim cannot be included as a liability when considering the solvency of the estate.

Lastly, Debtors argue that even if the estate is insolvent, the confirmed plan is still not fair and equitable because "it transfers control of Debtors' enterprise to GP 19 without compensating Debtors equitable interests for this right."

The Franke/Gannon parties filed a cross-appeal. In footnote 18 of their appellees' brief they explain that they filed the cross-appeal to ensure that the Bankruptcy Court's valuation of the Franke adversary proceedings not have preclusive effect in any subsequent proceedings. They contend that the Bankruptcy Court erred in valuing this proceedings at $4,510,000. They note, however, that this Court need not decide the merits of the cross-appeal which would become moot if the orders of the Bankruptcy Court's orders are

affirmed. In their "reply on cross-appeal," the Franke/Gannon parties set forth in full their arguments as to why the Bankruptcy Court erred in its valuation of the Franke adversary proceedings. They argue that all the challenged transfers made by Carnegie Evans to Franke were proper. They again note that the cross-appeal would be moot if the Bankruptcy Court orders are affirmed. Debtors have filed a motion to dismiss the cross-appeal and to strike the "reply on cross-appeal," on the ground that Debtors reasonably believed the cross-appeal was waived by the Franke/Gannon parties' failure to file a cross-appeal brief, and by the language in footnote 18.

On the main appeal from the confirmation and valuation orders of the Bankruptcy Court, the Franke/Gannon parties argue that Debtors were insolvent, and that the Bankruptcy Court properly considered future cash flow in its "going concern" valuation and properly allowed the HUD and Franke claims. They argue that the confirmed plan does not provide HUD (or its successor in interest, Prairie Properties, L.L.C.) with a prohibited bonus, i.e., payments greater than the value of HUD's claim. Lastly, they argue that the equities favor affirmance since GP 19 has operated the properties successfully for the last six years. Prairie filed a separate appellee's brief. It too asserts that GP 19 has been successfully operating the properties from the confirmation date to the present.

This Court reviews the Bankruptcy Court's finding of fact for clear error and its conclusions of law de novo. *In re Hen House Interstate, Inc.*, 150 F.3d 868, 870 (8th Cir. 1998). The valuation of assets of an estate are questions of fact and due deference must be accorded to the trier of fact,

especially when it is clear that the trier of fact carefully evaluated a voluminous record. *In re Da-Sota Elevator Co.*, 939 F.2d 654, 657 (8th Cir. 1991); *see also In re Muncrief*, 900 F.2d 1220, 1223 (8th Cir. 1990) (finding that debtor was insolvent is subject to clearly erroneous standard of review). Whether the method of valuation used was correct, however, is a legal question. *In re King Resources Co.*, 651 F.2d 1326, 1335 (10th Cir. 1980); *In re Moulded Products, Inc.*, 474 F.2d 220, 225-26 (8th Cir. 1974) (Chapter 10 reorganization case). The appellant has the burden of demonstrating why a finding of fact is clearly erroneous. *McDowell v. Safeway Stores, Inc.*, 753 F.2d 716, 717 (8th Cir. 1985).

Chapter 11 of the Bankruptcy Code contemplates that a reorganization plan may provide for the sale of all of the property of the estate. 11 U.S.C. § 1123(b)(4); *In re Sandy Ridge Dev. Corp.*, 881 F.2d 1346, 1352 (5th Cir. 1989) ("although Chapter 11 is titled 'Reorganization,' a plan may result in the liquidation of the creditor"); In re Ionosphere Clubs, Inc., 184 B.R. 648, 654 (S.D.N.Y. 1995); *In re River Village Assocs.*, 181 B.R. 795, 805 (E.D. Pa. 1995) ("as a matter of law, the Bankruptcy Code permits liquidation plans in Chapter 11 proceedings").

The Code anticipates that not all reorganizations will proceed with the assent of all participants. The Code also anticipates that confirmation may be desirable even though one or more classes, such as an equity class whose interests will be eliminated, refuse to accept the plan. For non-consensual confirmation, or "cramdown," all the requirement of § 1129(a) must be met with the exception of subsection (8) (acceptance by all classes); in addition § 1129(b)(1) requires

that as to the dissenting class, the plan be "fair and equitable" and not "discriminate unfairly." In § 1129(b)(2), the Code provides specific examples of possible fair and equitable treatment. *See* generally 7 Collier on Bankruptcy § 1129.03-.04 (15th ed. 1999).

Section 1129(b)(2)(C)(ii) provides that a plan is fair and equitable if the holder of any interest junior to the dissenting impaired class will not receive or retain any property under the plan. In the present case it is undisputed that there are no interests which are junior to Class 11. Thus the confirmed plan satisfies this section.

In *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 84 L. Ed. 110, 60 S. Ct. 1, (1939), the Supreme Court explained that the words "fair and equitable" are words of art that have a special meaning when used in the context of reorganization cases. To be "fair and equitable," plans must recognize that the debtor's interest in the property "is subordinate to the rights of creditors; first of secured and then of unsecured creditors." *Id.* at 116. "The 'fair and equitable' requirement [of § 1129(b)] does not look towards protection of debtor interests, but rather toward protection of dissenting creditor interests, absent the value of the ongoing business being large enough to support protection of the debtors." *In re Koelbl*, 751 F.2d 137, 140 (2d Cir. 1984).

When a plan extinguishes equity interests, a principal "fair and equitable" consideration is whether the debtor is insolvent. E.g., *In re Toy & Sports Warehouse, Inc.*, 37 B.R. 141, 152-53 (Bankr. S.D.N.Y. 1984). Under the rule of priorities, "if the corporation is insolvent, the shareholders may not participate in the reorganized corporation." *In re*

Moulded Products, Inc., 474 F.2d at 225. The debtor is insolvent if "the aggregate amount of its property, as measured by its going concern value, is insufficient to pay its debts." *Id.*

Debtors rely on *Protective Committee for Independent Stockholders of TMT Trailer Ferry, Inc. v. Anderson,* 390 U.S. 414, 20 L. Ed. 2d 1, 88 S. Ct. 1157 (1968), to support its argument that the Bankruptcy Court erred in the valuation of the "going concern" of the properties. In that case, the Chapter 11 debtor was a company engaged in transporting freight on seagoing vessels. The Bankruptcy Court, relying only on the debtor's past earnings, found that the debtor was insolvent and confirmed a reorganization plan that excluded the debtor's stockholders. The Supreme Court held that because the record "showed that the past earning record was not a reliable criterion of future performance . . . the sound evaluation of the company as a going concern required examination of the future prospects of the company." *Id.* at 452-453. Specifically, the Court noted, the debtor "was engaged in a hotly competitive market, a market experiencing a severe rate war which would probably alter the relative standings of the competitors. The market as a whole was witnessing substantial technological change, and [the debtor] itself was one of the prime innovators. [The debtor']s principle market . . . was undergoing considerable expansion." *Id.* at 452.

In the present case, there is nothing in the record to suggest that the Income Capitalization Approach, relied upon by the Bankruptcy Court, was not an appropriate valuation method. This method adequately took into account anticipated future profits. *Cf. In re King Resources Co.*, 651 F.2d at

1335-36 (capitalization of future earnings was proper method of valuation). Thus, there was no reversible error in the Bankruptcy Court's rejection of Debtor's proffered valuation expert testimony.

The Bankruptcy Court correctly held that HUD had a security interest in postdefault rents upon the recording of the mortgage which contained an assignment of rents provision. *See Indian Motocycle Assocs. III Ltd. Partnership v. Massachusetts Housing Fin. Agency*, 66 F.3d 1246, 1254 (1st Cir. 1995) (under federal common law, security interest of HUD in post-default National Housing Act rents is perfected by recording HUD mortgage containing assignment of rents); *United States v. Landmark Park & Assocs.*, 795 F.2d 683, 685-86 (8th Cir. 1986) (rights of federal agencies lending funds by authority of federal legislation are derived from federal not state law; predefault recording by HUD of documents containing rent assignment provision gave HUD perfected security interest in postdefault rents).

The Court finds no error of fact or law in the Bankruptcy Court's rulings with regard to the Bond Stabilization Fund, the tax refunds, and the Franke adversary proceedings. These are all property subject to HUD/Prairie's liens. In sum, the Bankruptcy Court committed no reversible error in its findings and conclusions that the estate was insolvent. The Court has considered Debtor's remaining arguments and finds them to be without merit.

Accordingly, the orders of the Bankruptcy Court are affirmed. The Gannon/Franke parties's cross-appeal is dismissed as moot.

Dated this 26 day of May, 1999.

/s/_____
Stephen N. Limbaugh
UNITED STATES DISTRICT JUDGE

APPENDIX D

IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

[December 18, 1997, Submitted]

No. 99-2705

IN RE: WESTPOINTE, L.P.,	)
A MISSOURI PARTNERSHIP,	)
DBA WESTPOINTE APARTMENTS,	)
Debtor	)
	)
NORTHWEST VILLAGE LIMITED	)
PARTNERSHIP; GRANDVIEW	)
HILLS LIMITED PARTNERSHIP;	)
PARKRIDGE APARTMENTS	)
LIMITED PARTNERSHIP;	)
LAMPLITE LIMITED PARTNERSHIP;	)
WESTPOINTE LIMITED PARTNERSHIP	)
Debtors-Appellants,	)
	)
v.	)
	)
WILLIAM E. FRANKE;	)
GANNON MANAGEMENT	)
COMPANY OF MISSOURI;	)
PRAIRIE PROPERTIES, L.L.C.;,	)
Creditors-Appellees.	)

NORTHWEST VILLAGE LIMITED PARTNERSHIP; GRANDVIEW HILLS LIMITED PARTNERSHIP; PARKRIDGE APARTMENTS LIMITED PARTNERSHIP; LAMPLITE LIMITED PARTNERSHIP; WESTPOINTE LIMITED PARTNERSHIP	)
Debtors-Appellants,	)
	)
v	)
	)
PRAIRIE PROPERTIES, L.L.C.,	)
Creditor - Appellee	)
	)
CYNTHIA MCNEILL,	)
Interested Party-Appellee.	)
	)
SUSMAN, SCHERMER, RIMMEL & SHIFRIN,	)
Movant-Appellee	)
	)
WILLIAM E. FRANKE; GANNON MANAGEMENT COMPANY OF MISSOURI;	)
Creditor-Appellee	)
	)

Appeal from the United States Bankruptcy Court
for the Eastern District of Missouri
Eastern Division

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MEMORANDUM

At Saint Louis, in this District, this 18th day of December, 1997.

BACKGROUND

This matter is before the Court on remand from the United States District Court for the Eastern District of Missouri directing that the Bankruptcy Court make findings as to the value of the Debtors' real property and cash assets; and make such determination of the value of the Debtors' assets and the amount of the Debtors' liabilities as of June 22, 1992, the date of the entry of the Order confirming the Plan proposed by the Appellees (The Gannon Management Company of Missouri or"Gannon"). An evidentiary hearing was held Sept ember 9 through 12, 1996. The Court granted the parties' requests to file post-trial memoranda. The findings and conclusions in this Memorandum are based on the record as a whole and are the final determinations of the Bankruptcy Court.

The former Debtors are five limited partnerships that owned five apartment complexes (the "Properties" or "Projects") in St. Louis County, Missouri. At the time of the filing of the bankruptcy petitions, the Appellants (Kevin Kelly and Pentad Properties, Inc., the general partners of each partnership; and St. Louis Associates ("SLA"), the sole limited partner of each partnership) operated the Debtors.

Since confirmation, the Properties have been operated by Gannon Partnership 19 L.P. ("GP19") under the Confirmed Plan. William E. Franke is the managing general

partner and his children and various officers of Gannon Management Company of Missouri are the limited partners of GP19. The Appellees reported to the Court that two transactions remain to be consummated under the Plan. First, relying on the terms of the Plan and the pendency of the appeal, the Appellants have not formally executed deeds transferring title of the real properties to GP19. Second, again relying on the pendency of the appeal, approximately $300,000.00 in the Bond Stabilization Fund has not been transferred to GP19.

This matter has been remanded for the sole purpose of conducting a hearing to determine the value of the estates' assets and the amount of the Debtors' liabilities as of June 22, 1992, for the purpose of plan confirmation. The Court has reviewed the record as a whole as well as the testimony and evidence presented at the hearing. For the reasons discussed below, the Court finds and concludes that the Debtors' assets as of June 22, 1992 were $56,394,669.77 and their liabilities as of that date were $75,829,331.24.

For purposes of this Memorandum, the operative dates are the date on which the Debtors filed the petitions that commenced these cases, September 7. 1990; and the date of confirmation of the Plan of Reorganization, June 22,1992. Upon commencement of these cases, five Bankruptcy estates were created, and the Debtors operated their businesses as Debtors in Possession. Generally, confirmation of a Chapter 11 plan terminates the pre-confirmation bankruptcy estates and distributes property of the estate according to the terms of the confirmed plan. *In re The Landina,* 191 B.R. 160 (Bankr. E.D.Mo. 1996); *Harstad v. First American Bank,* 39 F.3d 898 (8th Cir. 1994). In this proceeding on remand, the

Appellants are the pre-confirmation Debtors; and the Appellees are the proponents of the confirmed plan.

The Appellants and the Appellees disagreed as to several matters including whether certain items were property, of the estates; the value that should be attributed to those items if they are found to be property of the estates; whether certain items would be subject to liens; and the existence of certain debts. These disagreements extended to the "going concern value" as defined by the Appellants; the value of an adversary proceeding initiated by the Debtors in Possession against the U.S. Department of Housing and Urban Development ("HUD") and various other parties (the "HUD Adversary"); the value of an adversary proceeding against William Franke and Gannon Management Company (the "Franke Adversary"); and whether money disbursed from the Bond Stabilization Fund after the fund's termination belongs to the Appellants or, if found to be property of the estates, whether it is subject to HUD's lien.

On the liability side, the parties disagreed as to the amount of HUD's allowed secured claim and the allowance of certain other claims against the estates.

The parties submitted a considerable amount of documentation and other materials in this matter. There is a temptation in these circumstances for the Court to address each item that is suggested by the pleadings or the documentation. Although the Court and its staff have carefully reviewed the entire record in this matter, the determinations in this Memorandum are limited to those specific issues articulated in the District Court remand, and do not include a consideration of extraneous material and collateral issues that

otherwise may have been suggested.

ASSETS

The parties stipulated to the value of certain assets. *First Amended Joint Stipulation of Uncontested Facts*, File Document 393. The Court finds and concludes that the values as stipulated are consistent with the record in this case.

Properties (Real Estate & Improvements)	Stip. #152	$38,600,000.00
U.S.A. Cash Collateral Account	Stip. #33	$ 9,235,513.67
223(f) Escrows	Stip. #36	$ 2,587,632.21
DIP Accounts	Stip. #34	$ 330,408.00
Attorney Retainer Trust Account	Stip. #44	$ 72,434.00
Lamplite 1991 Property Tax Refund	Stip. #152*	$ 52,716.06
Northwest Village 1991 Property Tax Refund	Stip. #151*	$ 37,187.72
Tenant Security Deposits	Stip. #28	$ 328,344.00
Tenant Accounts Receivable	Stip. #40	$ 129,411.61
Prepaid Expenses	Stip. #42	$ 163,077.85
Union Electric Deposit	Stip. #30	$ 27,218.44

Other Utility Deposits	Stip. #31	$ 12,353.03
Non-Tenant Accounts Receivable	Stip. #41	($ 22,328.82)
SUBTOTAL		**$51,553,967.77**

*Contingent as of June 22. 1992

On consideration of the record as a whole, the Court has made the following determinations as to the inclusion and the value of the remaining assets of the estates.

Going Concern Value

The definition of property of the bankruptcy estate under the Bankruptcy Code is intended to be very broad. It includes all of a debtor's legal and equitable interests in property as of the commencement of the case, wherever located and by whomever held. 11 U.S.C.§ 541.

It was the Appellants' argument that the Bankruptcy Court failed ta value the "going concern value" of the estates as an asset for purposes of confirmation. The Appellants defined the Debtors' "going concern value" as the "sum of what an outside investor would pay to the Estate for the privilege of occupying GP19's ownership position in the [Gannon/Franke Plan". The Appellants valued this ownership privilege at $7,711,402.00, *See File Document* 349 page 31.

This amount was the Appellants' estimate of the present values of: the assumed projected cash flow from the

Properties; the estimated residual value of the then 61 to 67 year old apartment projects in the year 2031 when the loan would be paid off; and the value of management fees over a twenty year period. *Letter from The Valuations Group to Mr. Castle*, Appellees' Exhibit 96 and 97. The Court finds that the value of the cash flow, residual value; and the cost of managing the Properties are factors a purchaser of the Properties would consider, and that these values were in fact included in the appraisal of the overall value of the Properties submitted by the proponents of the plan. *See Real Property Appraisal* by *Tellatin*, Louis & Andreas, Inc., Appellees' Exhibits 7 and 8. To the extent the Appellants have argued that the "going concern value" is something other than the value attributable to the ongoing enterprise of the Properties, the Court disagrees.

Neither the ownership position of GP19 under the Gannon/Franke Plan, nor the beneficial value flowing therefrom, was property of the estates prior to confirmation of the plan. Prior to confirmation of the Gannon/Franke Plan, no GP19 ownership position existed. Whatever value the GP19 ownership position may have under the Gannon/Franke Plan is a consequence of the confirmation of that Plan. The GP19 ownership position was not an asset that the estates possessed independent of the, Gannon/Franke Plan. The estates did not propose the Gannon/Franke Plan. To the extent that the GP19 ownership interest generated any benefit prior to confirmation, such benefit possessed no dollar value to the estates until and unless the Plan was confirmed. As such, the GP19 ownership interest was not property of the pre-confirmation estates and is given no value in the confirmation consideration. Any argument that the plan proponent should be required to pay for a value that it will create only if its plan

is confirmed is totally inappropriate.

The Court finds and concludes that the "going concern value", as defined by the Appellants, was not a pre-confirmation asset of the estates. No sum of money could have been paid to the estates that would have resulted in a transfer from the estates to another entity of GP19's ownership position under the Gannon/Franke Plan.

However, the term "going concern value", when used in reference to apartment projects similar to those being considered here, means the ability of the project to generate a stream of rental income. *See Aboussie v. United States*, 779 F.2d 424, 428 (8th Cir. 1985)(The court found that an apartment complex begins to function as a going concern when it is substantially ready to generate income from the rental of apartments).

As a general definition, the term "'going concern value" is the value attributable to the ongoing operation of an enterprise. *See Jones Truck Lines, Inc. v. Full Service Leasing Corporation*, 83 F.3d 253, 258 (8th Cir. 1996), *United States v. Edgar*, 971 F.2d 89, 93-94 (8th Cir. 1992). When the term is defined as the value attributable to the ongoing operation of an enterprise, "going concern value" describes an interest in property of the estate under section 541. In these Chapter 11 cases, the Debtors' "going concern value" had been included as part of the enterprise value of the Properties that was submitted in support of confirmation of the Plan. *See Appraisal Report of the Properties*, Appellees' Exhibits 7 & 8.

The Appellants have argued that the Gannon/Franke

Plan unfairly deprives the Appellants (Kelly, Pentad, and SLA) of their ownership interest in the Properties. However, Appellants'ownership interest was not an interest of the Debtors in property, and was therefore, not includable as property of the estates pursuant to Section 541. To the extent that the Appellants' are requesting that their ownership interest be valued and included in the bankruptcy estate, such request is denied. The question of the value of the Appellants' ownership interest in the Debtors is not before the Court.

Assets Subject to Liens

The parties have extensively argued the question concerning the extent of HUD's lien on certain property of the estates. The Debtors have contended that any cash on hand on the date of the filing of the petition, the post-petition rents collected by the Debtors through December 16, 1990, the funds deposited in the attorneys' escrow account, the funds received by the Debtors upon the termination of the Bond Stabilization Fund and any interest earned by any of this money is free and clear of HUD's lien. The Debtors have stated further that these funds plus the money they expected to receive from the successful prosecution of the Adversary Proceedings would have been available to the Debtors to fund a plan of reorganization.

For the reasons stated below, the Court finds and concludes that the above listed assets were subject to HUD's lien by virtue of HUD's pre-petition security interest on all of the Debtors' property. HUD is the successor in interest to the Government National Mortgage Association ("GNMA").

Carnegie Evans Corporation ("Carnegie Evans"), the

originator and servicer of the mortgages on the five Debtor Properties, endorsed the notes and assigned its interest in the deeds of trust and security agreements to GNMA at the loan closings on November 18, 1988 and January 31, 1989. Appellants'-Brief, page 7. The HUD mortgage, security agreements and Regulatory Agreement were recorded with the other loan and closing documents and agreements. Thereafter, GNMA, a federal agency, was the lender and Carnegie Evans was the servicer of the loans. *See Huff v. GNMA*, 1995 WL 31563 at 3 (N.D. Ill. January 26, 1995) *citing* 12 U.S.C. § 1723 et seq.

The Debtors were notified by a letter from GNMA on December 13, 1989 that Carnegie Evans was relieved of its duties as servicer of the loans and that future draw requests were to be directed to GNMA. On February 24, 1990, HUD made findings that there had been a diversion of mortgage proceeds from authorized uses and recommended that no further draws from the escrows be advanced. The last timely payment made by the Debtors was March 3, 1990. On April 13, 1990, GNMA notified Franke that it would not approve further draw requests from Gannon. The Debtors failed to make the scheduled March debt service payment on April 16, 1990. GNMA notified the Debtors that they were in default on the loans on May 1, 1990. On September 7, 1990, the five Debtors filed separate Petitions for Relief under Chapter 11.

The Court finds and concludes that under federal common law and consistent with the terms of the recorded security agreement, GNMA's security interest in the post-petition rents and all real and personal property of the Debtors was perfected.

The pre-petition perfection of a security interest in property of the estate is normally determined by reference to the applicable state law. *See Butner v. United States,* 440 U.S. 48, 50, 99 S. Ct. 914, 918, 59 L. Ed. 2d 136 (1979). However, it is now well settled that the requirements for perfecting the lien of a federal agency's security interest in property securing a federally insured loan is controlled by federal common law. *Indian Motorcycle Associates III Limited Partnership v. Massachusetts Housing Finance Agency,* 66 F. 3d 1246, 1253 (1st Cir. 1995) *citing United States v. Kimbell Foods,Inc.,* 440 U.S. 715, 726, 99 S. Ct. 1448, 1457, 59 L. Ed.2d 711 (1979); *Burner,* 440 U.S. at 55, 99 S. Ct. at 918, *Landmark Park & Assoc.,* 795 F. 2d 683, 685-685 (8th Cir. 1986)(remaining citations omitted). Under well established federal common law, HUD's security interest in post-default National Housing Act rents is normally perfected upon the recording of a HUD mortgage containing an assignment of rents, which places third parties on notice of HUD's lien, *Indian Motorcycle Associates III Limited Partnership v. Massachusetts Housing Finance Agency,* 66 F. 3d 1246, 1253 (1st Cir. 1995) *citing Landmark Park & Assoc.,* 795 F. 2d 683, 685-686 (8th Cir. 1986). The security agreement may require the lender to make an express declaration of default in order to enforce its assignment of rents. *Indian Motorcycle Associates,* 66 F. 3d at 1250, *citing In re Executive House Assoc.,* 99 B.R. 266, 275-76 (Bankr. E.D. Pa. 1989).

The Debtors have urged the Court to find that certain terms of these agreements appear to require that state law procedures be followed if the assignment of rents provisions are to be enforced. The Debtors have argued that the terms of these agreements between Carnegie Evans and the Debtors

should be binding upon the successor federal lenders. *See Assignment of Rents and Leases*, ¶ 3. However, paragraph 4 of that document expressly provides that nothing in the Assignment shall operate to deprive the lender of any rights under the deed of trust, the Regulatory Agreement or any other instrument relating to the debt. *Id* at ¶ 4. To the extent the Assignment of Rents and Leases sought to change the substantive rights of the federal lender as to its assignment of rents, it was inoperative.

Other courts have found, and this Court agrees, that the assignment of rents provision in the Regulatory Agreement is not merely a term in a private loan agreement, but a contractual precondition to coinsurance which Congress expected HUD to enforce in the public interest. *Indian Motorcycle Associates,* 66 F.3d at 1250-1251. Federal housing, lending, and insurance programs are financed with public funds. Allowing private agreements to divert money from or jeopardize the repayment of those funds would undermine the public confidence in .those programs and subvert the Congressional intent, *See In re Garden Manor,* 70 B.R. 477, 483 (Bankr. N.D, Cal. 1987). There is an overriding federal interest in protecting the public trust and the federal treasury which gives rise to the need for a uniform federal rule for the perfection of security interests in rents. *See Landmark Park& Assoc.*, 795 F, 2d at 685-686.

Therefore, the Court finds and concludes that upon recordation of the documents, GNMA as an agency of the federal government, and subsequently HUD, had a perfected security interest in all property of the Debtors pursuant to the documents such as the mortgages, Regulatory Agreements and security agreements. Upon notification of default to the

Debtors on May 1, 1990, GNMA, and subsequently HUD, had all the rights reserved to it pursuant to these documents, including the right to collect the rents, and a perfected lien on all Project funds.

The Adversary Proceedings Pending at Confirmation of the Plan

The Debtors had filed adversary proceedings that had not been concluded when the Plan was confirmed. To the extent that the Debtors' had a claim in each proceeding, the HUD Adversary and the Franke Adversary were property of the bankruptcy estates pursuant to Section 541. For purposes of this remand, the Court has estimated the value of these Adversary Proceedings to the estates as such value-existed prior to Confirmation. The Court has not considered the effect of the Confirmed Plan in determining the pre-confirmation values of these Adversaries; however, the Court has considered the record as a whole, including information contained in the Confirmed Plan.

a) The HUD Adversary Proceeding

The Debtors as Plaintiffs, filed five adversary proceedings that were consolidated under number 90-4286 (the "HUD Adversary"). The original Defendants were 1) the United States Department of Housing and Urban Development, and Jack Kemp, Secretary; 2) the Government National Mortgage Association ("GNMA"); 3) Mellon Financial Services Corporation; 4)Mellon Financial Services Corporation #9; 5) Carnegie Evans, L.P.; and 6) Gannon Management Company. A Second Amended Complaint did not list Mellon Financial Services Corporation

("Mellon"),Mellon Financial Services Corporation #9 or Gannon Management Company as defendants. *Second Amended Complaint Memorandum of Law*, Adversary File Document number 54. HUD was the holder of the mortgages on the five Debtor Properties and was the primary party from whom the Debtors were seeking relief in this Adversary.

In their prayer for relief, the Plaintiffs requested that the Court 1) order turnover of the Special Funds accounts and any other funds of any kind and any records or any other property of the estates to the Debtors' control; 2) issue a Declaratory Judgment that the loan Agreements between the Debtors and Carnegie Evans, GNMA and/or FHA were breached by those parties and that the Debtors are not in default on the loans as a result of the Defendants' antecedent breach; 3) find that the Special Funds accounts are property of the estates; 4) order Equitable Recission of certain agreements and Reformation of other agreements with HUD; 5) order Equitable Subordination of the claims of the Defendants to all other claims of the estates; and 6) transfer all liens to the Plaintiffs.

On February 10, 1993, several months after the confirmation of the Gannon/Franke Plan, the Court entered an Order in the HUD Adversary finding that as to Count I, the Debtors' had an interest in the Special Funds accounts which was property of the estate, but that turnover would not be ordered. The Court held that, in light of the liens held by HUD and the confirmation of the Gannon/Franke Plan. the estates' interest was tenuous in nature and valued at zero. *See Order*, Adversary 90-4086, File Document 86. The Court held that the confirmation of the Plan rendered the remaining counts moot. *Id.* For purposes of this Remand, the Court has

determined the pre-confirmation value of this Adversary Proceeding as set out below.

In the Regulatory Agreements the term "Project" included the Mortgaged Property and all of its assets. *See Regulatory Agreement Multifamily Housing Projects Insured* by HUD. The rental income was an asset of the Mortgaged Property and thus was Project Funds, as were the proceeds of the federally insured loan. The Regulatory Agreements required that certain amounts of loan proceeds were to be held by Carnegie Evans or its assignees in Special Funds accounts. Money in these accounts was to be released for the payment of certain specified purposes only upon the occurrence of certain events or upon the satisfaction of various certain conditions precedent. Any amounts remaining in the Special Funds accounts after all such payments were made, would become Surplus Cash and as such would become property of the Debtors so long as the Debtors fulfilled the terms of the Regulatory Agreements and did not engage in any events of default. *See Order*, Adversary 90-4086, File Document 86 and Regulatory Agreements. Until such time as the money in the Special Funds accounts became Surplus Cash, it remained Project Funds. All Project Funds and all Project assets were subject to HUD's lien. *See Deed of Trust (Multifamily) and Security Agreement* (for section 223(f) coinsurance projects), Exhibit B,¶¶4 and 7. The required Special Funds accounts were initially under the control of Carnegie Evans, then GNMA, and finally HUD with disbursement at the discretion of the lender in accordance with the agreements. *Escrow Deposit agreement for Repairs*,¶¶ 2, 3 and 4, *Escrow Agreement Additional Contribution by Sponsors*, ¶ 5.

As of June 22, 1992, the date of confirmation of the

Plan, the Debtors were in default under the terms of the Agreements, having made no timely mortgage payment after March, 1990. The Debtors had not cured the default, had not offered to cure the default, and had not offered adequate protection for the use of the Special Funds accounts; and they had not proposed a confirmable plan of reorganization. *See Order*, Adversary 90-4286, File Document 86. Thus, absent the likelihood of a judgment favorable to the Debtors in the HUD Adversary, the value of the bankruptcy estates' interest in the Special Funds accounts was zero. However, were the Plaintiffs to prevail in this Adversary Proceeding and be granted the relief requested, HUD's liens on the Debtors' real and personal property would be extinguished. Therefore, in order to estimate the inchoate value of the HUD Adversary to the bankruptcy estates, the Court has estimated the likelihood and extent of the Plaintiffs' success in pursuing this Complaint.

In their Complaint, Plaintiffs prayed for relief based on allegations that HUD/GNMA/FHA misrepresented the relationship between Carnegie Evans, the originator and servicer of the Debtors' loans, and the various governmental/regulatory agency Defendants. The alleged misrepresentations occurred when the Defendants failed to disclose to the Plaintiffs the concerns the Defendants had about Carnegie Evans. The Plaintiffs contended that HUD knew or should have known that the Plaintiffs would rely on the relationship between HUD and Carnegie Evans and that therefore, a failure to inform the Plaintiffs of any concerns prior to the closing was a material misrepresentation.

It was the Plaintiffs' argument that by this material misrepresentation the Defendants breached the agreements

prior to the Plaintiffs' default, thus excusing the Plaintiffs' default.

The Plaintiffs also argued that HUD's refusal to release requested Special Funds to pay for repairs resulted in what the Debtors described as an "artificially created constructive default". *Second Amended Complaint, Memorandum of Law*, Adversary 97-4286, File Document 54. The Debtors argued that they were unable to make timely mortgage payments because the rental income generated by the Properties that was supposed to be paid to the lender was instead used by the Debtors to pay the costs of repairs. The Debtors contended that this diversion of Project Funds was necessary to avoid the filing of mechanic's liens against the West Pointe complex prior to its grand reopening.

It was the Plaintiffs' contention that certain wrongful disbursements to Gannon/Franke by Carnegie Evans prior to Carnegie Evans' default on its payments on the Mortgage Backed Securities and the Industrial Revenue Bonds (which led to GNMA dismissing Carnegie Evans as servicer on the loan), and the refusal by HUD to release money from the Special Funds accounts to pay the mortgages when the Debtors were unable to do so were breaches of the Agreements antecedent to the Plaintiffs' breach.

HUD's response to the Complaint was to file a Motion to Dismiss based on two grounds; failure to state a claim, and lack of subject matter jurisdiction.

First, as to the duties that may be owed by HUD to the Plaintiffs, HUD contended that the Plaintiffs failed to state a claim in that HUD owed the Plaintiffs no duty with regard to

the HUD/Carnegie Evans relationship, nor did the Plaintiffs have a right to rely on any representations or non-representations about that relationship. HUD argued that the Plaintiffs also failed to state a claim in that the Plaintiffs were not justified in relying on the government's rules, regulations and guidelines included as part of the Agreements as being intended for their protection. It was HUD's contention that the federal treasury and the public at large were the intended beneficiaries of the government rules, regulations and guidelines, not parties such as the Plaintiffs.

Second, HUD contended that the Bankruptcy Court had no subject matter jurisdiction to hear a matter that involved a claim of misrepresentation against an agency of the federal government. Such jurisdiction was preempted by the sovereign immunity of the United States and the *Federal Tort Claims Act*, 28 U.S.C. §§ 13,46(b); 2670 *et seq*.

The Plaintiffs did not offer support for their argument that the rules, regulations and guidelines contained in the Regulatory Agreements were intended to protect the Plaintiffs or created a duty owed to the Plaintiffs. The Court finds HUD's arguments to be well taken. A review of analogous case law compels the Court to conclude that the rules, regulations and guidelines promulgated pursuant to federal statutes governing the programs of the various federal agency Defendants do not give rise to a private cause of action. Such rules and regulations were implemented to protect the public treasury and were not intended to protect individual parties such as the Plaintiffs. *See United States v. Neustadt,* 366 U.S. 696, 709, 81 S. Ct. 1294, 1301, 6 L. Ed. 614 (1961); *United States v. Johnson,* 853 F.2d 619, 622 (6th Cir. 1988); *United States v Longo*, 464 F.2d 913, 915 (8th Cir. 1972); *In re*

Franklin National Bank Securities Litigation (Gold v. Ernst & Ernst), 44.5 F.Supp. 723, 730-731 (E.D.N.Y 1978); *Moon v. Taklsaki,* 501 F.2d 389, 390 (9th Cir. 1974).

Legal precedent supports HUD's claim that the Bankruptcy Court lacked subject matter jurisdiction to hear this matter. The *National Housing Act*, 12 U.S.C. § 1702, recognizes a partial waiver of sovereign immunity to permit suits against the Secretary in his official capacity. Recovery pursuant to this statute is limited. *See United States v. Bert & Berk v. York Associates, Inc.*, 767 F. Supp. 593, 600 (D. N.J. 1991) citing *Federal Housing Administration v Burr*, 309 U.S, 242, 60 S. Ct. 488, 84 L Ed. 740 (1940). The National Housing Act ("NHA") does not constitute a waiver of sovereign immunity for tort claims for damages under the *Federal Tort Claims Act* ("FTCA"). 28 U.S.C. §§ 1346(b) and 2671, *Berk & Berk*, 767 F.Supp. at 601.

There is a limited waiver of sovereign immunity for breach of contract actions provided by 28 U.S.C. § 1346(a) for damage claims under $10,000,00. The United States court of Claims has exclusive jurisdiction over claims in excess of $10.000.00. 28 U.S.C. § 1346(a). The requests of the Debtors as Plaintiffs in this Adversary are in excess of $10,000.00, and therefore, to the extent the claims are based on breach of contract, it is highly likely that this Court is without subject matter jurisdiction pursuant to 28 U.S.C.§-1346(a)

To the extent that the Debtors' alleged injuries were caused by HUD's allegedly improper discretionary acts as to the Special Funds accounts or with respect to the mortgages, 28 U.S.C. § 2680(a) provides that the limited waiver of

sovereign immunity for tort claims under the FTCA does not apply to an act or omission of a government employee exercising due care in the execution of a statute or regulation or upon the performance or failure to perform a discretionary function or duty on the part of a federal agency or government employee, whether or not the discretion involved was abused. 28 U.S.C. § 2680(a). 28 U.S.C. § 2675(a) applies to require, as a prerequisite to filing suit in district court, that plaintiffs present such claims to the appropriate federal agency for adjudication. The record does not reflect that such action has been taken and it appears that this Court has no subject matter jurisdiction to hear such claims as they have been presented in this matter.

The Debtors arguments have suggested that any alleged acts in the nature of breach of contract or improper discretion were a consequence of the alleged misrepresentation by HUD. It was the Debtors' contention that their default was precipitated by events, proximately caused by HUD's misrepresentation to the Debtors of the status of the HUD-Carnegie Evans relationship prior to the closing of the loans. The tort of misrepresentation is specifically excluded from the waiver of sovereign immunity by the FTCA. 28 U.S.C. § 2680(h), *United States v. Neustadt*, 366 U.S. 696, 711,81 S. Ct.1294, 1302, 6 L. Ed, 2d 614 (1961), *Farmers State Savings Bank v. Farmers Home Administration*, 891 F.2d 200, 201 (8th Cir. 1989). The Plaintiffs' underlying cause of action for their claims is the alleged misrepresentation, a tort claim. Unless the federal government expressly waives sovereign immunity, it appears that this Court would have no subject matter jurisdiction in this area.

The Court finds and concludes that the apparent lack of subject matter jurisdiction in the Bankruptcy Court to adjudicate the claims presented in this Adversary Proceeding severely impacts the value of these claims.

Were the Plaintiffs to proceed in the proper forum, and in conformity with the appropriate procedures, the probability that they would be able to carry their burden of proof to support the claim that a duty was owed to them pursuant to the federal rules, regulations and guidelines, or that a misrepresentation occurred regarding a relationship upon which the Plaintiffs were justified in relying would, be highly unlikely. In the circumstances presented here, the Court must also consider whether the Debtors would be justified in expending estate assets to prosecute these potentially lengthy proceedings in view of the likely outcome.

The Court finds and concludes that the bankruptcy estates' interest in the HUD Adversary proceeding had a pre-confirmation value of zero.

b) The Franke Adversary

The Debtors filed five adversary proceedings against William Franke ("Franke") and Gannon Management Company ("Gannon") that were consolidated under number 91-4193 (the "Franke Adversary"). The complaint concerned certain transfers made by Carnegie Evans to Gannon and Franke from the Special Funds accounts or from the interest earned by the Special Funds accounts. The six count complaint was for 1) turnover to the Debtors, pursuant to Section 542(a), of property of the estate including records and money paid by Carnegie Evans; 2) avoidance of fraudulent

transfers; 3) avoidance of preferential transfers, pursuant to Section 547(b)(4)(B), in the amount of $2,813,455.00 and disallowance of all claims against the estate by William Franke and Gannon; 4)judgment against Gannon in the amount of $2,813,455.00 for breach of fiduciary duty; 5) judgment in the amount of $1,125,000.00 against William Franke, and $77,000.00 against Gannon for conversion; and 6) judgment in an unliquidated amount for breach of contract.

The Defendants' Answer was the last pleading filed in the case. Thereafter, the Adversary was continued generally as a pre-trial proceeding along with the HUD Adversary and other matters in the main case, to allow the Parties to concentrate on issues relating to confirmation.

In their answer, the Defendants denied each allegation separately and specifically, thus requiring the Plaintiffs to prove each allegation in order to make a prima facie case. As to the counts for fraudulent transfers and preferential transfers, the Defendants raised various affirmative defenses including good faith exchange for value, contemporaneous exchange for new value, ordinary course of business and subsequent new value and as to the counts for conversion and breach of contract, the Defendants raised affirmative defenses including misrepresentations by the Plaintiffs, equitable estoppel and latches.

The Debtors stated in their brief in this valuation proceeding that it was the claims for fraudulent and preferential transfer which the Debtors considered to be "[o]ne of the major assets of the estate." *Debtors' Trial Brief for Valuation Hearing*, page 14.

The Debtors admitted that they were insolvent when the allegedly fraudulent and preferential transfers were made. A finding of fraudulent transfer under Section 548 requires that there be actual fraud, which the Debtors did not plead with particularity in their complaint, or that the Debtors received less than reasonably equivalent value in exchange. To establish a prima facie case based on alleged preferential transfers under Section 547, the Debtors must prove that the Defendants fit within the definition of "insiders" under Section 101 (31)(C), if the Court is to find that transfers outside the ninety day presumption period were preferential.

Gannon raised three affirmative defenses to rebut the presumption of preference. First, Gannon contended that, pursuant to Section 547(c)(1), the transfers were intended to be and in fact were substantially contemporaneous exchanges for new value given to the Debtors. Second, pursuant to Section 547(c)(2), the transfers were payments incurred in the ordinary course of the Debtors' business. Third, pursuant to Section 547(c)(4), Gannon argued that subsequent new value was given for the transfers. Franke also asserted that the Debtors had made certain fraudulent misrepresentations as to his rights to certain funds in order to induce him to release his original deed of trust on the Properties. *See Answer of William E. Franke and the Gannon Management Company of Missouri,* Adversary 91-4393, File Document 9.

The remaining counts presented difficult thresholds for the Debtors. To establish a basis for a right to a turnover, it is likely that the Debtors would be required to establish that Gannon was not a "custodian" within the meaning of Section 542(a). The Debtors would also be required to establish that Gannon owed fiduciary duties to the Debtors beyond the terms

of the contracts that were breached. The breach, of contract count would require the parties to clearly delineate the duties owed pursuant to the many, often inconsistent, agreements. To establish conversion, the Debtors would have to show that Gannon took the Debtors' property without justification

Any attempt by the Court to value this Adversary Proceeding on the basis of the Complaint and Answer on record would be speculative.

The Court finds that the value of the claims in this adversary for purposes of this consideration, may be ascertained by reference to a settlement between Gannon/Franke and HUD concerning the same nucleus of operative facts that pertains to these transfers. The settlement was reached prior to the confirmation of the Plan, and was to become effective upon confirmation. The settlement was noticed to all creditors and parties in interest prior to confirmation.

HUD alleged that certain payments to Franke and Gannon were made by Carnegie Evans from the Special Funds prior to the occurrence of certain events or conditions precedent. Such Prior Disbursements violated various federal RegulatoryAgreements and were wrongfully paid out of the Special Funds accounts that were subject to HUD's lien. *Consolidation, Modification and Assumption Agreement*, ¶¶ F and G. These Prior Disbursements were the same transfers complained of by the Debtors as being fraudulent or preferential transfers. HUD demanded that Franke repay these Prior Disbursements and a settlement was reached as memorialized in the Consolidation, Modification and Assumption Agreement ("CMA Agreement").

HUD based its demand for repayment from Franke and Gannon upon terms in the Regulatory Agreements. One provision acknowledged that neither the Owners (the Debtor Partnership's) nor any of their partners assumed personal liability for payments due under the Note and Mortgage; or for the payments that were to be made to the Reserve for Replacements; or for matters that were not under their control. However, the Agreement provided that the Owners remained liable under the Agreement for funds or property of the Projects coming into their hands which, by the provisions of the Regulatory Agreement, they were not entitled to retain. The Owners were also liable for their own acts and deeds or acts and deeds of others which they authorized in violation of the Regulatory Agreement. *Regulatory Agreement Multifamily Housing Projects Coinsured by HUD*, ¶ B.21. Damages recoverable by HUD for such breaches of the Regulatory Agreement include the return of any unauthorized distributions of Project Funds or Project Assets. *Id.* C.2. Given the history of this case it is likely that, should the Debtors have been successful in the prosecution of this adversary, HUD would have looked to them or their partners for the repayment of the Prior Disbursements.

Under the Regulatory Agreements, the Special Funds accounts were part of the collateral for HUD's loan. *Regulatory Agreement Multifamily Housing Projects Coinsured by HUD*, ¶ A.3(b)(4)-(7) & (9), B(1), (3)-(5), *Security Agreement* (for Section 223(f) coinsurance projects), Exhibit B, ¶¶ 4 and 7. The value of HUD's interest in the collateral would be protected by proper repair and maintenance of the Properties, and by proper disbursement of money from the Special Funds accounts for these purposes. To the extent the money was disbursed from the Special Funds

accounts without a corresponding increase in the Properties' value, HUD's collateral was reduced. As the recipients of the Prior Disbursements, and in light of the demise of Carnegie Evans and the bankruptcy of the Debtors. Franke and Gannon were the parties HUD looked to for repayment. In the CMA Agreement, HUD agreed to release Franke from all claims by HUD upon Franke's agreement to repay all Prior Disbursements made to Franke and Cannon from the proceeds of the HUD loans. *See CMA Agreement*, ¶¶ H-K.

The questions concerning whether the interest earned by the Special Funds was subject to HUD's lien, and the questions as to when and how transfers from the Special Funds were to be made, were governed by the terms of the Regulatory Agreements and by the Parties' other agreements which provided that HUD regulations superseded any conflicting terms. *See Regulatory Agreement Multifamily Housing Projects Coinsured by HUD, Reimbursement, Letter of Credit and Loan Agreement, Surplus Cash Agreement, Stabilization Fund Agreement, Deed of Trust Note, Deed of Trust (Multifamily), Security Agreement, Financing Statement, Assignment of Rents and Leases, Management Agreement*. Pentad, Franke and Carnegie Evans entered into various assignments and agreements, some of which were expressly subject to HUD regulations, as to the treatment of Surplus Funds and interest earned on the Special Funds. These assignments and agreements may have contained terms inconsistent with the Regulatory Agreements. *See Indemnification Agreement, Assignment and Security Agreement, Escrow Agreement Additional Contribution by Sponsors, Escrow Deposit Agreement for Repairs, Agreement Among Lenders, Promissory Note Modification Agreement, Supplemental Agreement to Promissory Note Modification*

Agreement, .Notice of Assignment of Escrow Accounts, Supplemental Collateral Agreement and Revision, Acknowledgment of Assignment of Agreement Among Lenders, Collateral Assignment and Security Agreement. From the language of the Regulatory Agreements and the Security Agreements, and from HUD's demand for repayment of Prior Disbursements, it is clear that HUD intended that its liens be all encompassing, and that the liens extend to the interest earned on any Project or Special Funds account or fund.

As the holder of the first deed of trust on the Properties, the largest secured claim, HUD's consent and cooperation was vital to confirmation of a plan and successful reorganization of the Debtors.

The record supports a finding that there were payments made to William Franke from the Special Funds accounts that were wrongfully disbursed by Carnegie Evans upon application by Franke and Gannon. The Debtors held an interest in those Special Funds accounts (as determined by the Court in the HUD Adversary) which was property of the Estates.

Pursuant to the CMA Agreement, Franke agreed to repay $4,510,000.00 to HUD. *CMA Agreement*, ¶ 4 page 9. Of this amount, $1,200,000.00 was to come from non-Project funds and the remainder from Project funds. *Id.* The record supports the conclusion that, although funds were wrongfully disbursed pursuant to the Regulatory Agreements, the Properties did receive a benefit from Gannon. Therefore, it was not unreasonable for the parties to agree that income generated by the Properties should be used to repay a portion of the wrongful disbursement. Since this repayment is in

addition to the regular payments due from the Properties, the effect of the HUD and Franke repayment agreement was to postpone the disbursement of any Surplus Cash to Franke/Gannon until HUD was satisfied.

In determining the amount of wrongfully disbursed funds, the Court was guided by the amount HUD and Franke/Gannon agreed to repay pursuant to the CMA Agreement. A redlined copy of the CMA Agreement, (Appellees' Exhibit 2B, 9-12-96) indicated that HUD and Franke/Gannon were negotiating an amount to be repaid that was between $5,595,000.00 plus the market rate of interest until the date of repayment, and the final agreed to amount of $4,510,000.00 with no interest requirement. *CMA Agreement*, page 9. Had the Gannon/Franke Plan not been confirmed, the CMA Agreement would not have become effective. However, the HUD-Gannon/Franke agreement for repayment of the Prior Disbursements would have remained part of the record of the case.

The Court finds that the repayment amount agreed to by HUD and Franke was similar to amounts listed in the Debtors' Complaint. The Court further finds that the amount is supportable by the CMA Agreement between the party responsible for the repayment and the party who held the lien on the funds. The amount agreed to by the parties during negotiations was reflective of the costs and uncertainty of further litigation as-considered by the parties. The amount of $4,510,000.00 is an amount that the parties with the greatest interest in the matter have accepted as either the amount wrongfully disbursed or the amount that is appropriate to repay in these circumstances.

The Court finds and concludes that the value to the estates of the claims in the Franke Adversary prior to confirmation, was $4,510,000.00, and that this is the appropriate valuation amount for confirmation purposes. This is not to say that the Court has accepted the Appellants' argument that the Adversary Proceeding had an unencumbered value to the estates. Prosecution of this Adversary would have been costly in both time and money to all the parties, and the record supports the further conclusion that the outcome was far from certain. The Court finds it likely that had the Debtors successfully prosecuted this Adversary Proceeding, HUD would have sought repayment from the Debtors or their partners. Pursuant to the terms of the Regulatory Agreement, the repayment of the Prior Disbursements would have been made to the project funds; an outcome not substantially different than the one achieved by the Franke/HUD settlement.

The Court has determined the value of these Adversary Proceedings as such value existed prior to confirmation of the plan. Any additional benefit or enhancement of value that arose after confirmation was solely the result of such confirmation, and is not included in this determination.

The Bond Stabilization Fund

The Projects generated income from rents which was paid to Carnegie Evans (and subsequently to GNMA), who then deposited the income into Mortgage Backed Securities ("MBS") at Boatmen's Bank. Carnegie Evans was required to make these bond payments even if revenues from the Projects were not sufficient to meet the payment. The parties procured a Letter of Credit from Sumitomo Bank to collateralize the

bonds. In the Debtors' apartment complexes known as Lamplite, Northwest Village and Park Ridge, the MBS payments were made to a trustee who in turn made payments to holders of certain Industrial Revenue Bonds ("IRB") that had been issued by St. Louis County. The agreements provided for an interest differential between the payment required for the MBS obligations and the lesser amount required for the tax free IRB. This interest differential was deposited into the Bond Stabilization Fund per the Agreements. The Bond Stabilization Fund was intended to reimburse Sumitomo Bank for the issuance of a Letter of Credit. *See Stabilization Fund Agreement and Surplus Cash Agreement.*

Under the Agreements, the termination of the Stabilization Fund Agreements was to occur on the Expiration Date or when all of the Debtors' obligations to the bondholders were paid in full. The money in the Bond Stabilization Fund was then to be paid to the "Company" or "Companies", defined in the Agreements as the limited partnerships owning the Projects. *Stabilization Fund Agreement, Preamble*, ¶¶ 1, 4(c)and 8; *Surplus Cash Agreement.*

The Bond Stabilization Fund was terminated when, following default by Carnegie Evans, GNMA paid the trustee the principal owed on the MBS in October, 1991. The trustee then paid the money remaining in the Bond Stabilization Fund to the three Debtor Companies.

The issue before the Court is whether, upon payment to the Debtors in the fall of 1990 (post-petition), the money was Surplus Cash, free of HUD's lien, or was Project Funds,

subject to HUD's lien, or was neither Surplus Cash or Project Funds, and thus free from liens.

The Stabilization Fund Agreement and the Surplus Cash Agreement provide that to the extent any of the provisions of the Agreements are in conflict with the provisions of the HUD Regulatory Agreement, the National Housing Act, the HUD Note, the HUD Mortgage, and HUD regulations, the latter shall govern. *Surplus Cash Agreement*, ¶ 8; *Stabilization Fund Agreement*, ¶ 1, *Surplus Cash definition*.

The Debtors' ability to use the Project Funds was limited by the terms of the Regulatory Agreements. The Debtors' use of certain money was not restricted only if funds were not Project Funds, or if Project Funds were subsequently denominated as Surplus Cash under the terms of the Regulatory Agreements. *Regulatory Agreements Multifamily Housing Projects Coinsured by HUD*, ¶ A.9. Project Funds could become Surplus Cash only when the mortgage obligations were met and the Debtors were not in default. *Regulatory Agreement*, ¶ A.9. At the time of the distribution of the Bond Stabilization Fund to these three Debtor Companies, the Debtors were in default on their loans to HUD. The money disbursed to the Companies upon termination of the Bond Stabilization Fund was therefore Project Funds in the hands of the Debtors in default.

The Court finds and concludes that the money disbursed from the Bond Stabilization Fund in the amount of $330,702.00 was Project Funds and was an asset of the bankruptcy estate subject to HUD's lien; and that the value of this asset for purposes of confirmation was $330,702.00.

Appraisal of the Properties

The parties stipulated that the value of the real properties and the improvements thereon as of June 22, 1992 was $38,600,000.00. The real properties and their improvements are the largest assets of the estates. Therefore, the Court makes the following findings and conclusions as to their value based on the evidence presented.

The Appellees provided the Court with an appraisal of the five Properties as of September 26, 1994 and as adjusted to June 22, 1992. *Appraisals of Properties*, Appellees' Exhibits 7 & 8. The Appellants did not dispute the findings and conclusions of the appraisers.

The goal of the appraisers was to find the "as is" fair market value of the Properties as of June 22, 1992. Fair market value was defined as "the most probable price that a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus." Appellees' Exhibits 7 & 8, page 2. The appraisers used three standard methods of appraising income producing properties in their evaluation. The first method used was the Cost Approach where the cost of reproducing or replacing the improvements is estimated and adjusted for depreciation. The value of the land, assumed vacant, was then added to find fair market value. *Id.* at 23.

The second method used was the Direct Sales Comparison Approach where recent sales of similar projects in the same kind of market in St. Louis were adjusted for any material differences that would affect value. *Id.*

The third valuation method used was the Income Capitalization Approach. This approach is based on the theory that purchasers of income producing property want a market rate of return on their investment, and that the fair market value of such property will reflect a similar anticipated rate of return. The Income Capitalization Approach calculates the present value of the anticipated stream of net income in order to derive the fair market value of the project. *Id.* The appraised value of the Properties on June 22, 1992 using the Income Capitalization Approach was between $37,180,000.00 (using the Direct Capitalization Technique) and $40,850,000.00 (using the Yield Capitalization Technique). Appellees' Exhibit 7 & 8, pages 23, 56-66, 96, 126, 155, 18S, and 214.

In summarizing their findings, the appraisers leaned heavily toward the Income Capitalization Approach to reach an opinion as to the value for these Properties. The !ack of available building sites or comparable sales at or near the same time caused the Cost Approach and Direct Sales Approach to be more speculative than the Income Capitalization Approach. The parties stipulated that the value of the Properties on June 22, 1992 was $38,600,000.00. The Court finds the value of the five Properties as agreed to by the Appellants and the Appellees to be supportable by the record, and finds and concludes that the value of the Properties on June 22, 1992 was $38,600,000.00. Total Assets as of June 22, 1992

The Court finds and concludes that the total value of the assets of the estates as of June 22, 1992 prior to

confirmation was $$6,394,669.77.[1]

LIABILITIES

The amounts of the liabilities listed below were stipulated to by the parties. *First Amended Joint Stipulation of Uncontested Facts*, File Document #393. The Court finds and concludes that these are pre-confirmation liabilities of the bankruptcy estates:

Administrative Claims	Stip. #45	$ 490,172.16*
Tenant Security Deposits	Stip. #29	$ 298,135.00
Union Electric Claim	Stip. #32	$ 27,218.44
Mechanic's Liens	Stip, #47	$ 1,650.00
Non-Insider Claims	Stip. #.48	$ 337,783.15
SUBTOTAL		$1,154,958.75

[1]In their brief, the Appellants noted that HUD hired John Ervin and Associates ("Ervin") to prepare estimates of the present values of the various plans of reorganization. The Appellants stated that the Ervin estimate of $58,295,100.00 for the present value of the Gannon/Franke Plan was reasonable and supportable. Appellants Brief, page 28.

*(Debtors' Attorney Fee - $397,014.16) (Disputed)
*(Debtors' Accountant Fee- $93,158,00)

Other Proofs of Claims

A claim or interest for which a proof of claim has been filed is deemed allowed as filed unless a party in interest objects. 11 U.S.C.§ 502(a).

Except as provided by certain subsections not applicable here, if an objection is made to a proof of claim, the court, after notice and a hearing, shall determine the amount of the claim as of the date of the filing of the petition and shall allow the claim in that amount subject to the listed exceptions in Section 502(b). 11 U.S.C.§ 502(b). An objection to a claim is a prerequisite/condition precedent to the application of any of the exceptions to the allowance of a claim listed under Section 502(b). If no objection is filed and no other exception applies, the claim is allowed as filed under 502(a).

The only objection filed by the pre-confirmation Debtors to a proof of claim was an objection to the late filed claim of the Missouri Department of Revenue. File Document 177, filed December 13, 1991. The claim was not allowed by Order of the Court entered March 24, 1992. File document 227.

HUD filed a proof of claim in each of the five cases, requesting allowance in the total amount of $64,897,724.00. Each claim as identified as a secured claim. William E. Franke filed a proof of claim in each of the five cases

requesting allowance and payment of an amount up to the value of the collateral as a secured claim. The remainder is to be allowed and paid as unsecured claims in the total amount of $9,290,192.25. The Gannon Management Company of Missouri filed a proof of claim in each of the five cases as general unsecured claims in the total amount of $486,456.24. No objections were filed to the proofs of claims filed by HUD, William E. Franke or the Gannon Management Company of Missouri. Therefore, the Court finds and concludes that these claims are deemed allowed in the amounts filed as pre-confirmation liabilities of the estates.

Prior to the confirmation of the Plan, Gannon Management Company filed objections to several proofs of claims filed in each of the five cases requesting adjustment to the amounts of the claims. Gannon also filed an objection to the amount scheduled by the Debtors on Schedule A-3 as being owed to Pentad Properties. File document 232. Following a hearing, these objections were sustained in part, and the proofs of claims were allowed in the amounts stated in the Order. The A-3 scheduled claim of Pentad was not allowed. *See Order* 265 dated July 16, 1992. Therefore, the Court finds and concludes that the claim of Pentad Properties was not a pre-confirmation liability of the estates, and the other listed claims were pre-confirmation liabilities of the estates in the amounts listed in Exhibits A and B of the Order dated July 16, 1992. These amounts have been included in the Parties' Stipulation. File document 265.

The Court finds and concludes that the total amount of the Debtors' liabilities as of June 22, 1992 prior to confirmation was $75,829,331.24.

CONCLUSION

ESTATE ASSETS

Stipulated Values	$51,553,967.77
Going Concern Value	-0-
HUD Adversary	-0-
Franke Adversary	$ 4,510,000.00
Bond Stabilization	$ 330,702.00
TOTAL	**$56,394,669.77**

ESTATE LIABILITIES

Stipulated Values	$ 1,154,958.75
HUD Claims	$64,897,724.00
Franke Claims	$ 9,290,192.25
Gannon Claims	$ 486,456.24
Pentad Claims	-0-
TOTAL	**$75,829,331.24**

By separate order, the value of the Debtors' assets, as of June 22, 1992, prior to confirmation, was $56,394,669,77; and the Debtors' liabilities, as of June 22, 1992, prior to confirmation totaled $75,829,331.24.

/s/_____
JAMES J. BARTA
Chief U.S. Bankruptcy Judge

Copy mailed to:

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Supreme Court, U.S.
FILED
SEP 13 2001
OFFICE OF THE CLERK

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No. 01-271

IN THE

Supreme Court of the United States

NORTHWEST VILLAGE LIMITED PARTNERSHIP,
GRANDVIEW HILLS LIMITED PARTNERSHIP,
PARKRIDGE APARTMENTS LIMITED PARTNERSHIP,
LAMPLITE LIMITED PARTNERSHIP, and
WEST POINTE LIMITED PARTNERSHIP,
Petitioners,

v.

WILLIAM E. FRANKE,
THE GANNON MANAGEMENT COMPANY OF MISSOURI and
PRAIRIE PROPERTIES, L.L.C.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF RESPONDENTS FRANKE AND GANNON IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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63pp

LIST OF PARTIES

Respondents The Gannon Management Company of Missouri ("Gannon") and William E. Franke ("Franke") (collectively, "Gannon/Franke") note that Petitioners misstate Gannon's correct legal name by omitting "The".

STATEMENT PURSUANT TO RULE 29.6

Gannon is a privately held corporation, with no parent corporation. No publicly held company owns 10% or more of Gannon's stock.

JURISDICTION

Gannon/Franke respectfully submit that this Court does not have jurisdiction over this matter, as the case is moot. Since the matter is moot, the constitutional jurisdictional requirement of "cases" or "controversies" has ceased to exist, mandating dismissal. *See* Section C below.

STATUTE INVOLVED

Gannon/Franke submit that the only statute at issue in this case is 11 U.S.C. § 1129 (plan confirmation requirements). Gannon/Franke dispute that any provision of the U.S. Constitution is properly implicated by the Petition.

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IN THE

Supreme Court of the United States

No. 01-271

NORTHWEST VILLAGE LIMITED PARTNERSHIP,
GRANDVIEW HILLS LIMITED PARTNERSHIP,
PARKRIDGE APARTMENTS LIMITED PARTNERSHIP,
LAMPLITE LIMITED PARTNERSHIP, and
WEST POINTE LIMITED PARTNERSHIP,
Petitioners,

v.

WILLIAM E. FRANKE,
THE GANNON MANAGEMENT COMPANY OF MISSOURI and
PRAIRIE PROPERTIES, L.L.C.,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF RESPONDENTS FRANKE AND GANNON IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF THE CASE

For their statement of the case, Gannon/Franke adopt and incorporate herein by reference the descriptions set forth in the decisions of the court of appeals and the district court below. *In re Westpointe, L.P.*, 241 F.3d 1005, 1007 (8th Cir. 2001); *In re Westpointe, L.P.*, 234 B.R. 431, 433-37 (E.D. Mo. 1999).

Further, in accordance with Rule 15.2, Gannon/Franke advise the Court of the following misstatements of fact and law contained in Petitioners' Petition for Writ of Certiorari ("Pet."):

1. Petitioners allege that "[t]he present value of [certain] cash flows and accumulation of equity was valued by the [Petitioners] at $7,711,402." Pet. p. 12 . Petitioners fail to advise the Court, however, that the bankruptcy court refused to certify as an expert Petitioners' proferred expert witness (Bryson Randolph) regarding this valuation issue, and refused to accept into evidence Randolph's report setting forth this valuation. The bankruptcy court's evidentiary rulings were upheld by the lower appellate courts, and are not at issue here. As there is no competent record evidence on this cash flow valuation issue, Petitioners' reference thereto and reliance thereon is improper.

2. Petitioners now challenge the Tellatin Appraisal, heavily relied upon by the bankruptcy court in its insolvency analysis. Pet. pp. 13, 16-22. Petitioners fail to advise the Court, however, that at the September, 1996 bankruptcy court insolvency hearing (the "Valuation Hearing"), Petitioners stipulated to the following: (i) Mr. Tellatin's qualifications as an expert in the fields of commercial real estate appraisal and valuation; and (ii) Mr. Tellatin's opinion of value of $38.6 million. Further, Petitioners did not object to the admission into evidence of Mr. Tellatin's appraisal report setting forth that $38.6 million value. .

3. Petitioners state that "there is an **undisputed**, substantial post-petition net income stream derived from the reorganized estate which . . . GP 19 gets to keep." Pet. p. 16 (emphasis added). In fact, there is no competent record evidence of any post-confirmation net income stream.

4. Petitoners state that "[t]he bankruptcy court . . . refused to consider the post-confirmation prospective net

cash flows to GP 19." Pet. p. 16. In fact, the bankruptcy court expressly considered these cash flows, finding that the cash flows (and other components) "were in fact included in the [Tellatin] [A]ppraisal of the overall value of the Properties . . ." Pet. Appendix ("Pet. App.") D 37a.

Further, in accordance with Rule 14.1(g)(ii), Gannon/ Franke advise the Court that federal jurisdiction in the bankruptcy court was proper pursuant to 28 U.S.C. §§ 157 and 1334 and Local Rule 29 of the United States District Court for the Eastern District of Missouri.

REASONS FOR DENYING THE PETITION

A. The Decision Of The Court Of Appeals Does Not Conflict With Decisions Of Other Courts Of Appeals Regarding Section 1129 Requirements.

1. Petitioners Misread or Misstate the Decision of the Court of Appeals Below.

The court of appeals properly rejected Petitioners' HUD claim bifurcation argument. In so ruling, the court stated that "[w]e reject Debtors' argument that HUD's failure to make an election under § 1111 (b) precludes treating the unsecured portion of HUD's claim the same as the secured portion of the claim, because the Franke/Gannon Plan clearly treated the two claims as part of the same class of interests and the Debtors failed to raise a proper and timely objection." Pet. App. A 6a-7a.

Petitioners, however, misread or misstate this aspect of the court's ruling. In a transparent attempt to create a conflict, Petitioners advise this Court that "the Eighth Circuit ruled in this case that the bankruptcy court could properly confirm the Plan **even if it did not comply with § 506(a) in its treatment of the HUD claim**, because the Debtors had failed to specifically object to the Plan's failure to separately classify the secured and unsecured portions of the HUD

Claim." Pet. p. 26 (emphasis added). Contrary to Petitioners' assertion, the court of appeals did not rule or imply that the Plan does not comply with section 506(a). The court of appeals did not hold that Petitioners' failure to raise a timely objection eliminated the duty of the bankruptcy court to independently determine that the Plan complies with section 1129. The court of appeals did not hold that the bankruptcy court abrogated its duty to independently determine that the Plan complies with section 1129. The court of appeals did not hold that the requirements of section 1129 are waivable. The court of appeals did not hold that the Plan fails to comply with section 1129. The ruling of the court of appeals below, accordingly, does not conflict with decisions of other courts of appeals regarding section 1129 requirements.

2. The Bankruptcy Court Expressly Found that the Plan Complies With the Applicable Provisions of Chapter 11.

In the June 22, 1992 order confirming the Plan (the "Confirmation Order"), the bankruptcy court expressly found that "[t]he Plan complies with the applicable provisions of Chapter 11 of the Bankruptcy Code . . ." Respondents' Appendix ("Resp. App.") B 24a. The bankruptcy court clearly did not abrogate its statutory duty under section 1129(a)(1). Accordingly, the decision of the court below does not turn on the waivability of section 1129 requirements.

Given the foregoing, this Court's review of the decision below clearly seems unwarranted. *See Layne & Bowler Corp. v. Western Well Works*, 261 U.S. 387, 393 (1923) (writ of certiorari should not be granted except in cases of significant public importance and "where there is a **real and embarrassing conflict of opinion and authority** between the Circuit Court of Appeals") (emphasis added). Indeed, review of the decision below would not provide this Court with any meaningful opportunity to advance the development of bankruptcy jurisprudence.

B. This Case Does Not Impact Persons Other Than Parties, And Does Not Implicate Any Issue Of Significant Public Importance.

1. This Case Represents a Fact Specific Valuation Determination.

When a plan extinguishes equity interests, a principal "fair and equitable" consideration under section 1129(b)(1) is whether the debtor is insolvent. *King Resources Stockholders' Protective Comm. v. Baer (In re King Resources Co.)*, 651 F.2d 1326, 1335 (10th Cir. 1980). A debtor is insolvent if its liabilities exceed its assets. 11 U.S.C. § 101(32)(B). The issue of insolvency is a factual determination, subject to the "clearly erroneous" standard of review. *Muncrief v. Mt. Prospect State Bank (In re Muncrief)*, 900 F.2d 1220, 1223-24 (8th Cir. 1990); *In re King Resources*, 651 F.2d at 1335.

Here, the Plan extinguishes the Class 11 partnership interests in Petitioners. Resp. App. A 16a. Accordingly, to determine whether the Plan is "fair and equitable" with respect to these extinguished interests, the bankruptcy court needed to determine whether Petitioners are insolvent.

To determine solvency, the bankruptcy court conducted a four day, full evidentiary hearing. 11 witnesses provided live testimony. The parties proferred over 150 joint factual stipulations. The parties submitted hundreds of exhibits and voluminous deposition transcripts. After carefully considering all competent evidence, the bankruptcy court ruled that Petitioners are insolvent by over $19 million.[1] The appellate courts below affirmed, in all respects, these factual determinations.

---

[1] The bankruptcy court determined the value of Petitioners' assets at $56,394,669.77, and Petitioners' liabilities at $75,829,331.24. Pet. App. D 67a.

Petitioners, in essence, now request that this Court overrule the detailed factual findings of the bankruptcy court. Even if the factual findings were clearly erroneous, which they are not, such a ruling by this Court would only impact Petitioners, Respondents and other parties in interest in the bankruptcy case. Such a ruling would not impact persons other than parties. Such a ruling would not implicate any issue of significant public importance. Gannon/Franke respectfully suggest that this garden variety factual dispute is not worthy of this Court's attention and resources.

2. The HUD Loan Program Purportedly at Issue Was Repealed.

Section 223(f) of the National Housing Act, 12 U.S.C. §§ 1701 *et seq.* (repealed 1990), authorized the HUD insured loans purportedly at issue here.[2] This statute, however, was repealed in 1990. Accordingly, any decision by this Court with respect to the provisions of section 223(f) will have no practical impact outside the bounds of this case.

3. This Case Does Not Implicate the "New Value" Exception.

Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988) addresses the "new value" exception to the "absolute priority" rule. Under this doctrine, if an estate is to be reorganized by a debtor, and all senior creditors are not paid in full, the debtor must contribute "new value" for the privilege of retaining ownership. Failure to contribute "new value" violates the "absolute priority" rule.

Here, the Plan provides that GP 19 receives the transfer of estate property. Resp. App. A 16a. Since Petitioners (formerly debtors) are not retaining ownership, *Ahlers* is wholly inapposite. Petitioners' reliance thereon is misplaced.

---

[2] Petitioners place considerable reliance on the purportedly favorable financing terms available under section 223(f). Pet. pp. 13, 16-22.

C. The Case Is Moot.

The U.S. Constitution confines federal court jurisdiction to those matters which embody actual "cases" or "controversies". U.S. Const. art. III, § 2, cl. 1; *Honig v. Doe*, 484 U.S. 305, 317 (1988). This requirement must be satisfied at each and every stage of the litigation. *Spencer v. Kemna*, 523 U.S. 1, 7 (1988). When a matter becomes moot, a case or controversy ceases to exist, and dismissal of the action is compulsory. *See City of Erie v. Pap's A.M.*, 529 U.S. 277, 287 (2000); *United States Parole Comm'n v. Geraghty*, 445 U.S. 388, 395-96 (1980).

A reviewing court should dismiss as moot a case when no effective, meaningful relief may be granted. *In re Information Dialogues*, 662 F.2d 475, 476-77 (8th Cir. 1981); *see also In re Continental Airlines*, 91 F.3d 553, 558-59 (3rd Cir. 1996). A court should consider a case moot and unreviewable when implementation of a plan of reorganization has created, extinguished, or modified rights, especially rights of parties not before the reviewing court, to such an extent that effective judicial relief is no longer available. *In re Andreuccetti*, 975 F.2d 413, 418 (7th Cir. 1992).

This doctrine of equitable mootness focuses on whether it is prudent to upset a plan of reorganization at a late date. *Continental Airlines*, 91 F.3d at 559. The doctrine reflects a court's concern for striking the proper balance between the equitable considerations of finality and good faith reliance on a judgment, and the competing interests that underlie the right of a party to seek review of a bankruptcy order adversely affecting it. *Manges v. Seattle-First Nat'l Bank* (*In re Manges*), 29 F.3d 1034, 1039 (5th Cir. 1994) (*citing First Union Real Estate Equity and Mtg. Inv. v. Club Assoc. (In re Club Assoc.)*, 956 F.2d 1065, 1069 (11th Cir. 1992)).

Factors courts consider in determining whether a case is moot include: 1) whether the confirmed reorganization plan has been substantially completed; 2) whether a stay has been

obtained; 3) whether the relief requested would affect the rights of parties not before the court; 4) whether the relief requested would affect the success of the plan; and 5) the public policy of affording finality to bankruptcy judgments. *Continental Airlines*, 91 F.3d at 560; *see also Manges*, 29 F.3d at 1039; *Andreuccetti*, 975 F.2d at 418.

The fact that no stay pending appeal was granted is particularly important in conjunction with equitable mootness. Further, it is not important whether the lack of a stay resulted from the failure to apply for a stay, or whether the lower court denied such application. "A stay not sought, and a stay sought and denied, lead equally to the practical implementation of a plan of reorganization." *In re UNR Indus., Inc.*, 20 F.3d 766, 770 (7th Cir. 1994). Absent a stay, third parties are encouraged to rely on the confirmation order and implementation of the plan of reorganization. *Id.*

Here, the bankruptcy court confirmed the Plan over nine years ago. There has been no stay pending appeal.[3] As a result, all of the estates have been equitably transferred to GP 19.[4] In reliance on the confirmed Plan, GP 19 has paid the claims of all allowed secured and unsecured claims, has made payments on HUD's Class 5 secured claim of over $51 million,[5] has incurred substantial expenses of over $5.5 million in the repair, rehabilitation, and maintenance of the projects, and has managed the day to day operations of the projects (Petitioners' former businesses) for over nine years.

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[3] Petitioners requested a stay at the bankruptcy court level, which was denied. Thereafter, Petitioners requested a stay at the district court level, which also was denied.

[4] In reliance on Plan definitions, prior appeals and this *certiorari* proceeding, Petitioners have not yet formally executed deeds transferring record title to the apartment projects to GP 19.

[5] HUD's Class 5 secured claim is now held by Respondent Prairie Properties, LLC ("Prairie").

Regarding the effect of the relief requested on parties not before this Court, reversal of the Plan at this late date would require massive disgorgement of funds paid years ago to numerous creditors, in some cases to entities which may not continue to exist. Payments on utility claims, tax claims, construction and repair expenses, just to name a few, would all have to be unwound. None of these parties is currently before this Court, yet each would be affected by the Court's action.

As to whether the relief requested would affect the success of the Plan, it is clear that reversal would destroy the nine year successful implementation of the Plan. As of this date, GP 19 represents a Chapter 11 bankruptcy success story. To reverse the Confirmation Order, and undo implementation of the Plan and nine years of successful business management, would be inequitable. *See Continental Airlines*, 91 F.3d at 553 (dismissing as moot an appeal argued three years following entry of the unstayed confirmation order); *Manges*, 29 F.3d at 1034 (dismissing as moot an appeal argued three years following entry of the unstayed confirmation order); *UNR Indus.*, 20 F.3d at 766 (dismissing as moot an appeal argued three years following entry of the unstayed confirmation order); *In re Roller*, 999 F.2d 346 (8th Cir. 1993) (dismissing as moot an appeal in a Chapter 12 case argued approximately one year following conversion to Chapter 7 and subsequent liquidation sales by trustee); *Information Dialogues*, 662 F.2d at 475 (dismissing as moot an appeal argued only eight months following entry of the unstayed confirmation order).

Finally, consideration of the public policy of affording finality to bankruptcy court judgments also strongly mitigates in favor of denying the Petition. Allowing review in a case such as this would likely undermine public confidence in the finality of bankruptcy confirmation orders and make successful completion of large reorganizations like this more difficult. *Continental Airlines*, 91 F.3d at 565.

In summary, effective relief can not be fashioned by this Court. Alternatively, even if this Court could fashion relief, implementation of that relief would be inequitable. This Court should deny the Petition on mootness grounds.[6]

D. Petitioners Lack Standing.

To enjoy standing to request review of an order of a bankruptcy court, a party must demonstrate that it is an aggrieved person, a party directly and adversely affected pecuniarily by the order. *In re Andreuccetti*, 975 F.2d 413, 416 (7th Cir. 1992); *In re El San Juan Hotel*, 809 F.2d 151, 154 (1st Cir. 1987); *In re Kieffer-Mickes, Inc.*, 226 B.R. 204, 208 (8th Cir. BAP 1998).

An insolvent debtor, therefore, does not have standing to contest an order of the bankruptcy court, because the debtor does not have a pecuniary interest in the distribution of assets of the estate. *Andreuccetti*, 975 F.2d at 417; *San Juan Hotel*, 809 F.2d at 154-55; *Kieffer-Mickes*, 226 B.R. at 208. The only exceptions to this rule are: 1) if a successful appeal by the debtor would create an estate that has assets in excess of liabilities; or 2) the appeal is from an order which affects the debtor's discharge. *Andreuccetti*, 975 F.2d at 417; *San Juan Hotel*, 809 F.2d at 156 n.6; *Kieffer-Mickes*, 226 B.R. at 209.

According to the valuation of the bankruptcy court, Petitioners' liabilities exceed assets by approximately $19 million. As a hopelessly insolvent debtor, Petitioners do not have standing to seek this Court's review of the decision below. Petitioners cannot contest the treatment of creditors contained in the confirmed Plan because no remedy available in this Court will affect the hopelessly insolvent Petitioners' rights.

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[6] Gannon/Franke moved to dismiss on mootness and lack of standing grounds before the court of appeals below. Since the court affirmed in Gannon/Franke's favor on the merits in all respects, it denied the dismissal motion as moot. 241 F.3d at 1009.

In addition, neither exception to this rule of standing applies here. The Petition cannot result in the creation of estates with assets in excess of liabilities. *See* section E below. Further, the Petition does not concern the discharge of Petitioners. This Court should deny the Petition on standing grounds.

E. The Decision Of The Court Of Appeals Is Correct.

1. No Evidence Shows Petitioners Are Solvent.

A fundamental flaw in Petitioners' arguments is that absolutely no competent record evidence shows Petitioners are solvent. Petitioners fail to cite any erroneous factual finding which, if corrected, would render Petitioners solvent.[7]

2. Petitioners' Valuation Methodology Argument Is Irrelevant.

It is undisputed that the liens of the Class 5 secured creditor (HUD, now Prairie) encumber all of the estate assets. *In re Westpointe, L.P.*, 241 F.3d 1005, 1008-09 (8th Cir. 2001).[8] Accordingly, Petitioners' valuation methodology argument is irrelevant. Regardless of the methodology used, whatever

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[7] Petitioners allege that the courts below failed to properly consider certain post-confirmation cash flows and equity accumulations, totalling $7,711,402. Pet. p.12. First, as set forth above, this "evidence" was properly excluded by the bankruptcy court, and these evidentiary rulings, upheld by the lower appellate courts, are not at issue before this Court. Accordingly, Petitioners' reliance on this purported "value" is improper. Regardless, Petitioners are insolvent by over $19 million. Even if Petitioners are correct regarding these post-confirmation cash flows and equity accumulations, which they are not, Petitioners still are insolvent by over $11 million.

[8] Petitioners contested the validity and extent of the Class 5 liens in the courts below. The court of appeals, agreeing with the bankruptcy court and district court below, found that the liens encumber all of Petitioners' assets. 241 F.3d at 1008-09. Petitioners do not challenge that finding in this Court.

increase in asset value arguably resulting therefrom is offset in the insolvency analysis (dollar for dollar) on the liability side by the HUD claim.[9]

F. Petitioners Have Stated An Intention To Attempt To Convert The Bankruptcy Case To Chapter 7 (Liquidation).

Petitioners have advised Gannon/Franke that they intend to attempt to convert the case to Chapter 7.[10] Gannon/Franke are confident that such a conversion attempt at this late date (nine years after confirmation of the Plan) is impermissible, would not succeed, and would not impact implementation of the Plan. Gannon/Franke fully intend to oppose any such attempt. Nonetheless, Gannon/Franke feel Rule 15 requires disclosure of this matter to this Court.

CONCLUSION

For all the foregoing reasons, Respondents William E. Franke and The Gannon Management Company of Missouri respectfully submit that the Petition for Writ of Certiorari should be denied.

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[9] Up to $64,897,724, the face amount of the total allowed HUD claim. *See* Pet. App. D 67a. Nothing in the record (or elsewhere) even remotely supports the proposition that the value of Petitioners' assets exceeds $64 million.

[10] *See* Resp. App. C-F 33a-42a. "I must report that there is a strong feeling that Chapter 7 is the way to proceed..." Letter from Kevin W. Kelly to Robert P. Greene (Sept. 7, 2001). Resp. App. F 41a. Mr. Kelly is the general partner of Petitioners, and Mr. Greene is the Executive Vice President of Gannon.

Respectfully submitted,

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APPENDIX A

IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

Case No. 90-44326-172
Case No. 90-44327-172
Case No. 90-44328-172
Case No. 90-44329-172
Case No. 90-44330-172

In re:

WEST POINTE LIMITED PARTNERSHIP, NORTHWEST VILLAGE LIMITED PARTNERSHIP, GRANDVIEW HILLS LIMITED PARTNERSHIP, PARK RIDGE APARTMENTS LIMITED PARTNERSHIP and LAMPLITE LIMITED PARTNERSHIP,
Debtors and Debtors-in-Possession.

FIRST AMENDED JOINT PLAN OF REORGANIZATION OF THE GANNON MANAGEMENT COMPANY OF MISSOURI AND WILLIAM E. FRANKE

DATED: January 31, 1992

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IN THE UNITED STATES BANKRUPTCY COURT
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Debtors and Debtors-in-Possession.

FIRST AMENDED JOINT PLAN OF REORGANIZATION OF THE GANNON MANAGEMENT COMPANY OF MISSOURI AND WILLIAM E. FRANKE

The Gannon Management Company of Missouri ("Gannon") and William E. Franke ("Franke") (collectively, the "Gannon Parties"), creditors and parties in interest herein, hereby propose the following First Amended Joint Plan of Reorganization (the "Plan") pursuant to Chapter 11 of the Bankruptcy Code.

ARTICLE I

DEFINITIONS

For purposes of the Plan, the following terms shall have the meanings herein set forth. Unless otherwise indicated, the singular shall include the plural. Capitalized terms shall at all times refer to terms as defined in this ARTICLE. A term used in this Plan, whether or not capitalized, that is not defined in this Plan, but that is used or defined in the Bankruptcy Code

or the Bankruptcy Rules, has the meaning used or defined in the Bankruptcy Code or the Bankruptcy Rules.

1.00 "*Allowed Administrative Claim*" shall mean any Allowed Claim arising from the costs and/or expenses of administration of these Chapter 11 Cases as, when and to the extent allowed pursuant to the Bankruptcy Code by the Court, including, without limitation, the actual, necessary costs and expenses of preserving the Debtors' estates and operating the businesses of the Debtors, all allowances of compensation or reimbursement of costs and expenses under Sections 330 and 503 of the Bankruptcy Code or otherwise allowed by the Court, and all Court fees and charges assessed against the Debtors' estates.

1.01 "*Allowed Claim*" shall mean: (i) a Claim that has been allowed by a Final Order of the Court; (ii) a Claim timely filed with the Clerk of the Court or scheduled as liquidated, undisputed and noncontingent by 'the Debtors in their statements and schedules heretofore filed with the Court, as they may be amended or supplemented, as to which Claim no objection to the allowance thereof has been interposed within the period of time fixed by the Bankruptcy Code or by a Final Order of the Court, or as to which Claim has resulted in the allowance of a Claim, in whole or in part, by a Final Order of the Court; or (iii) a Claim allowed under this Plan.

1.02 "*Allowed Mechanic's Lien Claim*" shall mean an Allowed Claim secured by a lien against the Property of the Debtors or in which the estates of the Debtors have an interest, which lien arises pursuant to the statutes of the State of Missouri relating to mechanic's liens.

1.03 "*Allowed Secured Claim*" shall mean an Allowed Claim which is secured by a valid perfected lien on Property of the Debtors or of the estates, to the extent of the value, as scheduled or as determined by the Court pursuant to Section 506(a) of the Bankruptcy Code, of the interest of the holder of

the Allowed Claim in the Property of the Debtors or of the estates securing such Allowed Claim, subject, however, to the further provisions of this Plan.

1.04 "*Allowed Unsecured Claim*" shall mean an Allowed Claim which is not entitled to priority under the Bankruptcy Code, or as to which the Creditor does not hold a validly perfected and enforceable lien or security interest as defined in Sections 101(37) and (51) of the Bankruptcy Code, or the amount of an Allowed Claim to the extent it exceeds the value of the interest of the holder of the Allowed Claim in the Property of the Debtors or of the estates securing such Allowed Claim, subject, however, to the further provisions of this Plan.

1.05 "*Available Funds*" shall mean the Stabilization Fund, the Escrows, the Transferred Funds, the USA Cash Collateral Account and Project operating accounts.

1.06 "*Bankruptcy Code*" shall mean the Bankruptcy Reform Act of 1978, Title 11 United States Code Section 101 *et seq.*, as the same has heretofore been and hereafter may be amended, to the extent that such amendment may be applied to these Chapter 11 Cases.

1.07 "*C. Franke Disputed Claims*" shall mean the Claims made by Cynthia J. Franke ("C. Franke") pursuant to the 5 separate adversary proceedings, 1 for each Debtor, filed with the Court and designated as adversary nos. 91-4242 through 91-4246 (the "C. Franke Adversary Proceedings").

1.08 "*Carnegie Evans*" shall mean Carnegie Evans Corporation, a Delaware corporation, which originated the loans evidenced by the HUD Notes and the HUD Deeds of Trust.

1.09 "*Cash*" shall mean U. S. Dollars paid and received by wire transfer into a bank account designated by the payee, or a regular, cashier's or certified check payable to the order of the payee in immediately available funds.

1.10 "*Chapter 11 Cases*" shall mean the cases of the Debtors under Chapter 11 of the Bankruptcy Code.

1.11 "*Claim*" shall mean a claim against the Debtors as defined in Section 101(5) of the Bankruptcy Code. Interest accrued on and accruing after commencement of the Chapter 11 Cases shall not be part of any Claim except with respect to an Allowed Secured Claim as permitted by Section 506 of the Bankruptcy Code.

1.12 "*Class*" shall mean any class in which Allowed Claims are classified pursuant to ARTICLE II hereof.

1.13 "*Confirmation*" shall mean the issuance by the Court of the Confirmation Order.

1.14 "*Confirmation Date*" shall mean the date upon which the Confirmation Order becomes a Final Order.

1.15 "*Confirmation Order*" shall mean the order issued by the Court confirming the Plan.

1.16 "*Consolidation Agreement*" shall mean the consolidation, modification and assumption agreement by and between G.P. 19 and HUD, the form of which is attached hereto as Exhibit 1 and incorporated herein by reference.

1.17 "*Court*" shall mean the United States Bankruptcy Court for the Eastern District of Missouri, a unit of the United States District Court for the Eastern District of Missouri.

1.18 "*Creditor*" shall mean the holder of a Claim against the Debtors.

1.19 "*Debtors*" shall mean the debtors-in-possession collectively; the individual Debtors are West Pointe Limited Partnership ("West Pointe"), Northwest Village Limited Partnership ("Northwest Village"), Grandview Hills Limited Partnership ("Grandview"), Park Ridge Apartments Limited Partnership ("Park Ridge") and Lamplite Limited Partnership ("Lamplite").

1.20 "*Effective Date*" shall be the date upon which distributions under the Plan are made, which date shall be not more than ninety (90) business days after the Confirmation Date.

1.21 "Escrows" shall mean the amounts transferred from GNMA to HUD as follows:

Debtor	Real Estate Tax, Ins. and MIP Escrows	Repair, Operating Deficit and GNMA Escrows	Reserve for Replacement Escrows
West Pointe	$412,762	$588,006	$524,315
Northwest Village	65,795	[264,381] [1]	131,086
Grandview	[13,700][1]	[123,190] [1]	46,212
Park Ridge	100,130	122,406	141,973
Lamplite	57,997	9,579	109,706
	$622,984 [2]	$332,420 [2]	$953,292[2]

1.22 "*FHA*" shall mean the Federal Housing Administration, a unit of HUD.

1.23 "*Final Order*" shall mean an order or judgment of the Court, which has not been reversed, stayed, modified or amended and: (i) as to which any rights to appeal or to seek certiorari review have been waived; or (ii) as to which the time to appeal or to seek certiorari review has expired and as to which no appeal or petition for certiorari, review or rehearing is pending.

1.24 "*Franke*" shall mean William E. Franke, an individual residing in the County of St. Louis, State of Missouri, a creditor and party in interest herein.

1.25 "*Franke Adversary Proceeding*" shall mean the adversary proceeding nos. 91-4193-172, 91-4205-172,

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[1] Negative balances are the result of the allocation of the Escrows among the Debtors made by Ernst & Young, accountants for the Debtors.

[2] Plus any interest earned from and after 12/31/90.

91-4206-172, 91-4207-172 and 91-4208-172 initiated by the Complaint for Turnover, Recovery of Fraudulent Transfers, Recovery of Preferential Transfers, Breach of Fiduciary Duty, Conversion and Breach of Contract, filed by the Debtors against Franke and Gannon, including any and all claims and causes of action asserted, or which could have been asserted, in connection with the matters described therein.

1.26 "*Franke Deeds of Trust*" shall mean the 5 multi-family subordinate deeds of trust, assignments of rents and security agreements, 1 for each Debtor, executed by the Debtors in favor of SLA as follows:

Debtor	D/T Date	Recording Date	Book/Page
West Pointe	11/18/88	02/03/89	B 8456, P 2442
Northwest Village	01/27/89	02/03/89	B 8456, P 2416
Grandview	11/18/88	02/03/89	B 8456, P 2429
Park Ridge	01/27/89	02/03/89	B 8456, P 2390
Lamplite	01/27/89	02/03/89	B 8456, P 2403

The Franke Deeds of Trust were assigned by SLA to Franke.

1.27 "*Franke Notes*" shall mean the 5 promissory notes, 1 for each Debtor, executed by the Debtors in favor of SLA as follows:

Debtor	Date	Original Principal Amount
West Pointe	11/18/88	$3,187,500
Northwest Village	01/27/89	813,750
Grandview	11/18/88	226,915
Park Ridge	01/27/89	795,000
Lamplite	01/27/89	517,500

The Franke Notes were assigned by SLA to Franke.

1.28 "*Gannon*" shall mean The Gannon Management Company of Missouri, a creditor and party in interest herein.

1.29 "*G.P. 19*"shall mean Gannon Partnership 19 L. P., a Missouri Limited Partnership with Franke as the managing general partner and John W. Shipley, Robert P. Greene, David W. Weygandt, Courtney Michelle Franke and Christin McKenzie Franke as the limited partners.

1.30 "*GNMA*" shall mean the Government National Mortgage Association.

1.31 "*HUD*" shall mean the United States Department of Housing and Urban Development, currently under the direction of its Secretary, Jack Kemp.

1.32 "*HUD Adversary Proceeding*" shall mean the consolidated adversary proceeding no. 90-4286-172 initiated by the Second Amended Complaint for Turnover, Reformation of Contract, Declaratory Judgment and Equitable Subordination, filed by the Debtors against HUD, FHA, GNMA and Carnegie Evans, including any and all claims and causes of action asserted, or which could have been asserted, in connection with the matters described therein.

1:33 "*HUD Deeds of Trust*" shall mean the 5 deeds of trust (multifamily), 1 for each Debtor, executed by the Debtors in favor of Carnegie Evans as follows:

Debtor	D/T Date	Recording Date	Book/Page
West Pointe	11/18/88	11/18/88	B 8416, P 1196
Northwest Village	01/27/89	01/27/89	B 8452, P 1619
Grandview	11/18/88	11/18/88	B 8416, P 1151
Park Ridge	01/27/89	01/27/89	B 8452, P 1571
Lamplite	01/27/89	01/27/89	B 8452, P 1671

together with the 5 security agreements (for section 223(f) coinsurance projects), 1 for each Debtor, executed by the

Debtors in favor of Carnegie Evans, and the 5 assignments of rents and leases, 1 for each Debtor, executed by the Debtors in favor of Carnegie Evans. The HUD Deeds of Trust were assigned from Carnegie Evans to GNMA, and from GNMA to HUD.

1.34 "*HUD Notes*" shall mean the 5 deed of trust notes, 1 for each Debtor, executed by the Debtors in favor of Carnegie Evans as follows:

Debtor	Date	Original Principal Amount
West Pointe	11/18/88	$36,125,000
Northwest Village	01/27/89	9,222,500
Grandview	11/18/88	2,571,700
Park Ridge	01/27/89	8,910,600
Lamplite	01/27/89	5,865,000

The HUD Notes were assigned from Carnegie Evans to GNMA, and from GNMA to HUD.

1.35 "*Kelly*" shall mean Kevin W. Kelly, a one-half of one percent (.5%) general partner in each of the Debtors.

1.36 "*New Regulatory Agreement*" shall mean the regulatory agreement multifamily housing project coinsured by HUD by and between G.P. 19 and HUD, the form of which is attached hereto as Exhibit 2 and incorporated herein by reference.

1.37 "*Other Allowed Secured Claims*" shall mean all Allowed Secured Claims, expressly *including* Allowed Mechanic's Lien Claims, but expressly *excluding* the Class 2 Security Deposit Claims, the Class 5 HUD Allowed Secured Claims, the Class 8 Franke Allowed Secured Claims and the Class 9 C. Franke Disputed Claims.

1.38 "*Pentad*" shall mean Pentad Properties, Inc., a Tennessee corporation, a one-half of one percent (.5%) general partner in each of the Debtors.

1.39 "*Petition Date*" shall mean September 7, 1990, the date on which the Debtors filed their Chapter 11 petitions with the Court.

1.40 "*Plan*" shall mean this First Amended Joint Plan of Reorganization, as altered, amended or modified in accordance with the terms hereof or in accordance with the Bankruptcy Code.

1.41 "*Projects*" shall mean all land described on Exhibit C-1 (West Pointe) to the Consolidation Agreement, Exhibit C-4 (Northwest Village) to the Consolidation Agreement, Exhibit C-2 (Grandview) to the Consolidation Agreement, Exhibit C-5 (Park Ridge) to the Consolidation Agreement, and Exhibit C-3 (Lamplite) to the Consolidation Agreement, and all improvements thereon.

1.42 "*Property*" shall mean all property of the estates of the Debtors in the Chapter 11 Cases as such term "property of the estate" is used in Section 541 of the Bankruptcy Code, including, but not limited to: (i) the Projects; (ii) Debtors' accounts receivable, cash, deposit accounts, money market or other investment accounts; (iii) all tangible personal property, furniture, inventory, machinery, equipment, goods and chattels owned or held by the Debtors together with all books of account, records, rent rolls, tenant information, promotional materials, accounts payable records and supporting documents, surveys, and drawings used by the Debtors in the management and ownership of the Property; (iv) all real estate, fixtures, leases, subleases, easements and personal property leasehold interests owned or held by Debtors together with all leasehold improvements and interests thereto; (v) all trademarks, trade names, service marks, copyrights, licenses, franchises and good will owned or held

by Debtors; (vi) all proposed leases of the Debtors from or with proposed tenants and purchase orders with suppliers; (vii) all contract rights, interests and claims held by the Debtors; (viii) any and all claims, counterclaims, or causes of action owned or held by the Debtors against any party, whether filed or unfiled, certain or contingent, including, without limitation, the HUD Adversary Proceeding and the Franke Adversary Proceeding; (ix) the Security Deposits; (x) the Escrows; (xi) the Stabilization Fund ; and (xii) the Transferred Funds.

1.43 "*Pro Rata*" shall mean the same proportion that an Allowed Claim in a particular Class bears to the aggregate amount of all Allowed Claims in such Class. To the extent that there exist disputed Claims in any such Class, Pro Rata share shall mean, until such disputed Claims shall, in whole or in part, have become Allowed Claims, the same proportion that an Allowed Claim in the Class bears to the aggregate amount of all Allowed Claims and disputed Claims in such Class.

1.44 "*Security Deposits*" shall mean the security deposits required by the leases entered into by the Debtors and tenants of the Projects, which deposits are held by the Debtors as security against damage and failure to pay rent as and when due.

1.45 "*SLA*" shall mean St. Louis Associates Limited Partnership (f/k/a St. Louis Associates, Ltd.), a Missouri limited partnership.

1.46 "*Stabilization Fund*" shall mean the funds generated pursuant to the Stabilization Fund Agreements, in the approximate aggregate amount of $279,716,[3] which funds currently are held by the Debtors.

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[3] Plus any interest earned thereon.

1.47 "*Stabilization Fund Agreements*" shall mean the 3 separate stabilization fund agreements, each dated January 1, 1989, by and between The Sumitomo Bank Limited Chicago Branch, The Boatmen's National Bank of St. Louis ("Boatmen's"), and Northwest Village, Park Ridge and Lamplite, respectively.

1.48 "*Transferred Funds*" shall mean the funds transferred to Susman, Schermer, Rimmel & Shifrin ("Susman, Schermer") and Colton & Boykin ("C & B"), counsel for Debtors, ostensibly as retainers for future legal services, immediately prior to the Petition Date, in the following amounts:

Recipient	Aggregate Amount Received
Susman, Schermer	$60,000
C & B	24,500
Total	$84,500 [4]

1.49 "*Unimpaired Creditors*" shall mean any Creditor, Creditors, interest holders or any Class of Creditors with Claims or interests that are not impaired under the Plan pursuant to Section 1124 of the Bankruptcy Code.

1.50 "*USA Cash Collateral Account*" shall mean the funds held by HUD pursuant to the terms of the 5 cash collateral orders, 1 for each Debtor, filed with the Court February 26, 1991.

1.51 "*Wrap Note*" shall mean the promissory note dated May 31, 1984, in the original principal amount of $57,300,000, executed by SLA in favor of Franke, as heretofore altered, amended or modified.

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[4] Plus any interest earned thereon.

ARTICLE II

CLASSIFICATION OF CLAIMS AND INTERESTS

2.01 *Class 1*: The holders of Allowed Administrative Claims, if any, against the Debtors which are entitled to priority under Section 507(a)(1) of the Bankruptcy Code.

2.02 *Class 2*: The holders of Allowed Claims, to the extent of $900 per individual, arising from Security Deposits, which are entitled to priority under Section 507 (a) (6) of the Bankruptcy Code.

2.03 *Class 3*: The Allowed Claim of St. Louis County, if any, arising from any outstanding real estate taxes relating to the Projects assessed for calendar year 1990, and any outstanding personal property taxes relating to the Property assessed for calendar year 1990, which is entitled to priority under Section 507(a)(7) of the Bankruptcy Code.

2.04 *Class 4*: The Allowed Claim of Union Electric Company.

2.05 *Class 5*: The Allowed Secured Claim of HUD.

2.06 *Class 6*: The holders of Other Allowed Secured Claims.

2.07 *Class 7*: The holders of Allowed Unsecured Claims of whatever nature and description, including Claims arising from the rejection of executory contracts and unexpired leases, *excepting* those Claims included in Classes 1 through 6 above and Classes 8 through 11 below.

Notwithstanding anything herein to the contrary, Class 7 shall not include any amounts due to Franke.

2.08 *Class 8*: The Allowed Secured Claim of Franke.

2.09 *Class 9*: The C. Franke Disputed Claims.

2.10 *Class 10*: The Allowed Unsecured Claims, if any, of Kelly and/or Pentad which are in addition to, and distinct from, any such Claims included in Class 11 below.

2.11 *Class 11*: The holders of partnership interests in the Debtors.

ARTICLE III

CLAIMS AND INTERESTS NOT IMPAIRED UNDER THE PLAN

3.01 *Class 1*. Such Creditors shall be paid in full on the Effective Date; *provided*, however, that such Creditors, other than professional persons, holding Claims resulting from ordinary course of business transactions may be paid in the ordinary course of business. In either event, payment will be made by G.P. 19 out of Available Funds. Class 1 is not impaired.

3.02 *Class 2*. Such Creditors shall be treated according to the terms of the leases entered into by the Creditors with the Debtors. Accordingly, such Creditors' legal, equitable and contractual rights remain unaltered. Class 2 is not impaired.

3.03 *Class 3*. Such Creditor shall be paid in full on the Effective Date. Payment will be made by G.P. 19 out of Available Funds. Class 3 is not impaired.

3.04 *Class 4*. The Debtors entered into an agreement with Union Electric ("UE") in January, 1991 pursuant to UE's demand for a deposit pursuant to Section 366 of the

Bankruptcy Code. Pursuant to the Agreement, the Debtors deposited the following amounts with UE:

Debtor	Amount Deposited
West Pointe	$19,729.80
Northwest Village	4,226.68
Grandview	4,579.70
Park Ridge	160.10
Lamplite	4,235.91
TOTAL	$32,931.47

The agreement calls for these amounts to be applied to the Allowed Claim of UE in satisfaction of the Claim. Accordingly, such Creditor's legal, equitable and contractual rights remain unaltered. Class 4 is not impaired.

3.05 *Class 6.* Such Creditors shall be paid in full on the Effective Date. Payment will be made by G.P. 19 out of Available Funds. Class 6 is not impaired.

3.06 *Class 7.* Such Creditors shall be paid in full on the Effective Date. Payment will be made by G. P. 19 out of Available Funds. Class 7 is not impaired.

3.07 *Class 9.* Such Creditor shall retain her rights, if any, and be allowed to litigate her Claims in any court of competent jurisdiction. Class 9 is not impaired.

ARTICLE IV

TREAT OF CLASSES THAT ARE IMPAIRED UNDER THE PLAN

4.01 *Class 5.* HUD is impaired under the Plan. The Allowed Secured Claim of HUD shall be treated as set forth in the Consolidation Agreement, which is attached hereto as Exhibit 1 and incorporated herein by reference.

4.02 *Class 8.* Such Creditor shall receive no distribution under the Plan. Class 8 is impaired.

4.03 *Class 10.* Such Creditors shall receive no distribution under the Plan. Class 10 is impaired.

4.04 *Class 11.* Such Creditors shall receive no distribution under the Plan. Class 11 is impaired.

ARTICLE V

MEANS FOR EXECUTION OF THE PLAN

5.01 On or before the Confirmation Date, HUD shall cause the Escrows and the USA Cash Collateral Account to be transferred to G.P. 19 for use in implementing the Plan.

5.02 On or before the Confirmation Date, the Debtors shall cause the Stabilization Fund, the Transferred Funds, the Security Deposits, and the Project operating accounts to be transferred to G.P. 19 for use in implementing the Plan.

5.03 On or before the Confirmation Date, G.P. 19 and HUD shall execute the Consolidation Agreement and the New Regulatory Agreement; and shall take and perform all actions contemplated thereby.

5.04 On or before the Confirmation Date, the Debtors shall sell, convey and assign the Property to G.P. 19. The Property will be acquired by G.P. 19 in exchange for G.P. 19 assuming and agreeing to pay the outstanding principal balance of the HUD Notes, such balance currently being in the amount of $62,322,434 and Franke additionally agreeing to pay the sum of $5,595,000 over a period of time as more particularly set forth in ¶ 4 of the Consolidation Agreement.

5.05 The Confirmation Order and the instruments of conveyance from the Debtors shall provide that the Property (except Cash required for distribution to Creditors pursuant to this Plan) be conveyed free and clear of restrictions on or conditions to transfer or assignment (except as set forth in the

HUD Deeds of Trusts [5] and the New Regulatory Agreement) and free and clear of deeds of trust, mortgages, security interests, liens, pledges, charges, encumbrances, equities or claims (except the HUD Deeds of Trusts and the New Regulatory Agreement); PROVIDED, however, that the Confirmation Order and the instruments of conveyance from the Debtors shall provide that, in the event a court of competent jurisdiction finds that C. Franke holds a lien on the Projects superior to the lien of the HUD Deeds of Trust, as alleged in the C. Franke Adversary Proceedings, the Property shall be subject to such interest in favor of C. Franke.

5.06 NO MONIES, PROPERTY OR FUNDS FOR THE PLAN, FOR ANY OF THE CREDITORS OR FOR ANY PAYMENTS UNDER THE PLAN, WILL BE PROVIDED BY FRANKE, GANNON OR G.P. 19 EXCEPT AS EXPRESSLY SET FORTH IN THE PLAN.

ARTICLE VI

RETENTION OF JURISDICTION

6.01 The Court shall retain jurisdiction of these Chapter 11 Cases pursuant to and for the purposes set forth in the Bankruptcy Code and to:

(a) Determine the amounts of any disputed Claims;

(b) Hear and fix allowances of compensation and other administrative expenses;

(c) Resolve issues related to the Plan;

(d) Insure that all parties comply with the provisions of the Plan and with all orders of the Court relating thereto;

---

[5] Post-Confirmation Date, all references herein to the HUD Deeds of Trust shall be deemed to incorporate the modifications set forth in the Consolidation Agreement.

(e) Act upon any executory contracts not heretofore rejected;

(f) Hear and determine all Claims resulting from the rejection of executory. contracts;

(g) Hear and act upon modifications to the Plan;

(h) Amend, correct any defect, cure any omission or reconcile any inconsistency in the Plan or in the Confirmation Order as may be necessary to carry out the purpose and intent of the Plan; and

(i) Address such other matters as may be set forth in the Final Order of Confirmation.

ARTICLE VII

PROVISION FOR REJECTION OF EXECUTORY CONTRACTS AND UNEXPIRED LEASES

7.01 All executory contracts and unexpired leases relating to the Property shall be deemed to have been rejected by the appropriate Debtor unless expressly assumed, as directed by and acceptable to G.P. 19, and Confirmation shall operate as such a rejection. Any person or entity that claims rights in any rejected executory contract or unexpired lease shall have thirty (30) days after rejection in which to file a Claim in these proceedings.

ARTICLE VIII

NONDISCHARGE OF DEBTOR

8.01 Notwithstanding anything to the contrary contained in the Plan or in the Bankruptcy Code, Confirmation of the Plan shall not discharge the Debtors from any of their debts.

ARTICLE IX

MODIFICATION OF PLAN

9.01 The Gannon Parties reserve the right, in accordance with the Bankruptcy Code, to amend or modify the Plan prior to the Confirmation Date. After the Confirmation Date, upon order of the Court, and in accordance with Bankruptcy Code Section 1127(b), the Gannon Parties may also modify the Plan.

ARTICLE X

GENERAL PROVISIONS WITH RESPECT TO CLAIMS OF CREDITORS

10.01 Unless a Creditor advises G.P. 19 in writing of a change of its address, all distributions or notices shall be sent to the Creditor at its address as listed on the statement of financial affairs or as stated on a properly filed proof of the Creditor's Claim.

10.02 Ninety (90) days after the final distribution made by G.P. 19 to any Class 1, 3, 4, 6 or 7 Creditor pursuant hereto, G.P. 19 shall stop payment on all checks remaining unpaid, if any. Any Creditor who fails to cash a check or checks prior to such date shall forfeit all rights thereunder. Any such amounts shall be added to the Available Funds.

10.03 With respect to any distribution of Cash pursuant to which any Creditor would receive less than $10.00, G.P. 19 shall not distribute such amount to such Creditor. Any amounts not so distributed shall be added to the Available Funds.

ARTICLE XI

MISCELLANEOUS

11.01 *Headings*. The ARTICLE and section headings in this Plan are for convenience of reference only and shall not modify, limit, expand or otherwise affect the interpretation of the provisions hereof.

11.02 *Entire Agreement.* The Plan sets forth the entire agreement and understanding of the parties hereto relating to the subject matter hereof and supersedes all prior discussions and documents. No party hereto shall be bound by any terms, conditions, definitions, warranties, understandings, agreements or representations with respect to the subject matter hereof, except as expressly provided for herein or as may hereafter be agreed to by the parties in writing.

11.03 *Cram Down.* If any impaired Class under the Plan shall fail to accept this Plan in accordance with Section 1129(a) of the Bankruptcy Code, the Gannon Parties reserve the right to request the Court to confirm the Plan pursuant to Section 1129(b) of the Bankruptcy Code.

THE GANNON MANAGEMENT COMPANY OF MISSOURI

By: /s/ William E. Franke
Name: WILLIAM E. FRANKE
Title: CHAIRMAN OF BOARD

WILLIAM E. FRANKE
/s/ William E. Franke
WILLIAM E. FRANKE

/s/ Majorie Morris Weisman
MAJORIE MORRIS WEISMAN
LLOYD A. PALANS, ESQ. #122650
TERRY L. PABST, ESQ. #37187
MARJORIE MORRIS WEISMAN, ESQ. #38704
BRYAN, CAVE, MCPHEETERS & MCROBERTS
1 Metropolitan Square
211 North.Broadway
St. Louis, Missouri 63102
(314) 231-8600

Attorneys for The Gannon Management Company of Missouri and William E. Franke

EXHIBITS

#1. Consolidation Agreement

#2. New Regulatory Agreement

APPENDIX B

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MISSOURI
EASTERN DIVISION

Case No. 90-44326-172
CHAPTER 11 PROCEEDING

In re
WEST POINTE LIMITED PARTNERSHIP, D/B/A
WEST POINTE APARTMENTS, a Missouri
Limited Partnership,
Debtor.

Case No. 90-44327-172
CHAPTER 11 PROCEEDING

In re
NORTHWEST VILLAGE LIMITED PARTNERSHIP, D/B/A
NORTHWEST VILLAGE APARTMENTS, a Missouri
Limited Partnership,
Debtor.

Case No. 90-44328-172
CHAPTER 11 PROCEEDING

In re
GRANDVIEW HILLS LIMITED PARTNERSHIP D/B/A
GRANDVIEW HILLS APARTMENTS, a Missouri
Limited Partnership,
Debtor.

Case No. 90-44329-172
CHAPTER 11 PROCEEDING

In re
PARK RIDGE APARTMENTS LIMITED. PARTNERSHIP D/B/A PARK RIDGE APARTMENTS, a Missouri Limited Partnership,
Debtor.

Case No. 90-4330-172
CHAPTER 11 PROCEEDING

In re
LAMPLITE LIMITED PARTNERSHIP, D/B/A SPRINGWOOD, APARTMENTS, a MISSOURI LIMITED PARTNERSHIP,
Debtor

ORDER CONFIRMING FIRST AMENDED JOINT PLAN OF REORGANIZATION OF THE GANNON MANAGEMENT COMPANY OF MISSOURI AND WILLIAM E. FRANKE

At Saint Louis, in this District, this 22nd day of June, 1992.

The Gannon Management Company of Missouri ("Gannon") and William E. Franke ("Franke") (collectively, the "Gannon Parties"), jointly filed with this Court under Chapter 11 of the Bankruptcy Code, 11 U.S.C. § 101 *et seq.* (the "Bankruptcy Code") their First Amended Joint Plan of Reorganization on February 11, 1992, as amended, including the subsequently filed modifications, addenda, exhibits and schedules thereto (collectively, the "Plan") (hereinafter, all capitalized terms in this Order not defined in this Order shall have the meanings defined in the Plan). A hearing was held before this Court on notice to all Creditors, interest holders

and other parties in interest to consider the Gannon Parties' First Amended Disclosure Statement filed on January 31, 1992 (the "Disclosure Statement"). The Disclosure Statement was approved by Order of this Court dated as of January 31, 1992, and a copy of the Plan, the Disclosure Statement and various related materials were duly transmitted to all known holders of Claims or interests as provided in the Order approving the Disclosure Statement. The solicitation of acceptances from holders of Claims or interests entitled to vote on the Plan in these Chapter 11 cases was made in the manner required by this Court. Thereafter, the Gannon Parties filed their Report of Balloting on the Plan, certain objections to the Plan and the confirmation thereof having been filed (collectively, the "Objections").

On June 16, 1992, the Court held a full evidentiary hearing to consider confirmation of the Plan and other natters relating to confirmation (the "Hearing") upon notice as heretofore directed. Upon consideration of the record as a whole, and after due deliberation and sufficient factual and legal cause appearing therefor, the Court announced its determinations and orders from the bench.

I. FINDINGS OF FACT

(a) The Plan complies with the applicable provisions of Chapter 11 of the Bankruptcy Code, including, but not limited to, the provisions regarding disclosure, solicitation of acceptances and modifications.

(b) The Gannon Parties, as proponents of the Plan, have complied with all applicable provisions of the Bankruptcy Code.

(c) The Plan designates Classes of Claims and interests.

(d) The classification of claims and interests is reasonable and consistent with 11 U.S.C. § 1122.

(e) The Plan specifies the Classes of Claims and interests not impaired under the Plan.

(f) The Plan specifies the Classes of Claims and interests impaired under the Plan and specifies the treatment of Claims or interests in such Classes.

(g) Except where the holder of a particular Claim or interest has agreed to less favorable treatment of such Claim or interest, the Plan provides the same treatment for each Claim or interest of a particular Class.

(h) The Plan provides adequate means for its implementation.

(i) The Plan has been proposed in good faith and not by any means forbidden by law. The record has failed to disclose any side agreements between the Gannon Parties and certain creditors that have not been adequately described or otherwise identified in these proceedings.

(j) Any payment made or to be made by the Gannon Parties, as Plan proponents, for services or for costs and expenses in or in connection with the Chapter 11 Cases, is subject to the approval of this Court.

(k) The Gannon Parties, as Plan proponents, have disclosed the identity of all insiders that will be employed by or retained by G. P. 19 and the nature of any related compensation.

(l) No governmental regulatory commission has jurisdiction over rates charged by the Debtors.

(m) With respect to each impaired Class of Claims or interests, each holder of a Claim or interest has either accepted the Plan or will receive or retain under the Plan on account of such Claim or interest property of a value, as of the Effective Date, that is not less than the amount that such holder would receive or retain if the Debtors were liquidated under Chapter 7 of the Bankruptcy Code.

(n) The Plan treats all Claims of the types specified in Section507 (a) (1) and 507 (a) (6) of the Bankruptcy Code in compliance with the provisions of Section 1129 (a) (9) of the Bankruptcy Code.

(o) At least one Class of Claims that is impaired under the Plan has accepted the Plan, determined without including any acceptance of the Plan by any insider.

(p) The Plan is feasible. The Gannon Parties and G. P. 19 have demonstrated their ability to meet their financial obligations under the Plan and continue their businesses in the regular course. Confirmation and consummation of the Plan are not likely to be followed by the liquidation, or the need for further financial reorganization, of G. P. 19, except as has been otherwise proposed in the Plan.

(q) All fees payable under Section 1930 have been paid or the Plan provides for the payment of all such fees on the Effective Date..

(r) Classes 1, 2, 3, 4, 5, 6, 7, 8 and 9 have either accepted the Plan, or are deemed to have accepted the Plan.

(s) The Plan does not discriminate unfairly against and is fair and equitable with respect to Classes 10 and 11 and the treatment to be afforded to each of them meets the requirements of Section 1129(b) of the Bankruptcy Code.

(t) As of the Confirmation Date, there are no Class 10 Allowed Claims, and there is no holder of any interest that is junior to Class 11 which will receive or retain any property under the Plan on account of such junior interest.

(u) G.P. 19 will provide good and adequate consideration in exchange for the transfer of the Property.

(v) G. P. 19 and Franke are not receiving or retaining any property under the Plan on account of any prior interest in the Debtors.

(w) The procedures by which the Class 5 Ballot was distributed and tabulated were fair, properly conducted and complied with the prior orders of this Court with respect thereto.

(x) In accordance with the order of this Court dated January 31, 1992, a Ballot accepting the Plan has been timely received from the holder of the Class 5 Allowed Claim, representing more than two-thirds in amount and more than one-half in number of the Allowed Claims in Class 5.

(y) The principal purpose of the Plan is not the avoidance of taxes or the avoidance of the requirements of Section f of the Securities Act of 1933.

(z) It is not necessary to resolve all remaining disputes regarding the Debtors or the Property prior to Confirmation.

(aa) The conditions precedent to Confirmation of the Plan have been satisfied.

(bb) Any of the foregoing findings of fact deemed to be conclusions of law are hereby incorporated as conclusions of law.

II. CONCLUSIONS OF LAW

1. This Court has jurisdiction over this proceeding and the persons and governmental units subject hereto, pursuant to 28 U.S.C. §§ 157 and 1334 and Local Rule 29 of the United States District Court for the Eastern District of Missouri.

2. The Objections to confirmation of the Plan which have not been withdrawn are overruled.

3. The Plan is hereby confirmed.

4. Consistent with the Plan and, in particular, Article V thereof, the agreements and documents which are attached to the Plan and Disclosure Statement, including the documents referred to therein, and the related documents filed to date with the Bankruptcy Court (collectively, the "Agreements"), and all terms and provisions thereof, are hereby approved.

5. The Gannon Parties and G.P. 19 are authorized to enter into, execute, deliver and/or implement the Agreements and all other documents, instruments and modifications consistent therewith or with the Plan, with any amendments to such documents, instruments and modifications being approved hereby, and to take such other steps and perform such other acts, including execution of any other documents or agreements as may be necessary to implement and effectuate the Plan and/or the Agreements or documents approved in this Order.

6. Distributions required to be made to the holders of Clams against the Debtors shall be made to the entities entitled thereto as provided in the Plan.

7. The Plan and its provisions shall be binding upon the Debtors, any entity acquiring property under the Plan, any holder of a Claim against or interest in the Debtors, whether or not the Claim or interest of such Creditor or interest holder or obligation of any party in interest is impaired under the Plan and whether or not such Creditor, interest holder or party in interest has accepted the Plan or filed a proof of Claim or interest.

8. The United States Department of Housing and Urban Development ("HUD") is to comply with the terms of the Plan concerning the transfer of Escrows and U.S.A. Cash Collateral Accounts.

9. Consistent with the terms of the Plan, and consistent with the terms of the Court's ruling and order to be entered with respect to the fee applications of Susman, Schermer, Rimmel Shifrin and Colton & Boykin, but not later than five (5) days after such ruling and order is final, the Debtors shall cause the Stabilization Fund, the Transferred Funds, the Security Deposits and the Project operating accounts to be transferred to G. P. 19 for use in implementing the Plan.

10. Consistent with the terms of the Plan, G.P. 19 and HUD shall execute the Consolidation Agreement and the New Regulatory Agreement and shall take and perform all actions contemplated thereby.

11. Consistent with the terms of the Plan, the Debtors shall sell, convey and assign the Property to G. P. 19. The Property will be acquired by G. P. 19 in exchange for G. P. 19 assuming and agreeing to pay the outstanding principal balance of the HUD notes, such balance currently being in the amount of $62,322,434, and Franke additionally agreeing to pay the sum of $4,510,000 over a period of time as more particularly set forth in paragraph 4 of the Consolidation Agreement.

12. The Property (except Cash required for distribution to Creditors pursuant to the Plan) shall be conveyed free and clear of restrictions on or conditions to transfer or assignment (except as set forth in the HUD Deeds of Trust[1] and the New Regulatory Agreement) and free and clear of deeds of trust, mortgages, security interests, liens, pledges, charges, encumbrances, equities or claims (except the HUD Deeds of Trust and the New Regulatory Agreement); PROVIDED, however, that anything herein to the contrary notwithstanding, the Property shall be and the instruments of conveyance from the Debtors shall provide that the Property shall be subject to the liens and claims of Cynthia Franke, if any, including the Cynthia Franke Disputed Claims, and nothing in the Plan or this Order shall require Cynthia Franke to litigate or adjudicate the validity or priority of her liens and claims against the Property, if any, prior to exercising here foreclosure rights, judicial or non-judicial, if any. The Plan, the New Regulatory Agreement, the Consolidation Agreement and/or this Order shall not alter or impair Cynthia

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[1] All references herein to the HUD Deeds of Trust shall be deemed to incorporate the modifications set forth in the Consolidation Agreement.

Franke's aforesaid liens or claims Nothing herein shall impair, modify, affect or alter the right, if any, of any party to contest the existence, validity, extent or priority of the liens or claims granted to Cynthia Franke hereunder or otherwise or to seek relief in a court of competent jurisdiction to enjoin the exercise of Cynthia Franke's foreclosure rights, if any.

13. Pursuant to Section 7.01 of the Plan, and in accordance with Sections 365 and 1123 (b) (2) of the Bankruptcy Code, all executory contracts and unexpired leases and subleases of the Debtors are deemed to have been rejected by the Debtors effective on the Confirmation Date.

14. Pursuant to Bankruptcy Rule 3002 (c) (4), a deadline to file proofs of Claim for damages arising from the rejection of executory contracts and unexpired leases and subleases pursuant to Section 7.01 of the Plan shall be set by the Court after application.

15. The filing of proofs of Clam for damages arising from the rejection of executory contracts and unexpired leases and subleases shall be without prejudice to the rights of the Gannon Parties and G. P. 19 to object to any such proofs of Claim.

16. G. P. 19 is hereby authorized and directed to make distributions on the Effective Date, or as soon as practicable thereafter, of the payments required under the Plan, consistent with the terms of the Plan.

17. Except as expressly provided herein, and consistent with the terms of the Plan, upon and after the Confirmation Date, G. P.19 shall be entitled to manage its properties and affairs without further order of the Bankruptcy Court.

18. Any of the foregoing conclusions of law deemed to be findings of fact are hereby incorporated as findings of tact.

19. Not later than five (5) working days after the date of this order, the Gannon Parties' counsel shall submit to the

Bankruptcy Court a proposed notice, consistent with Bankruptcy Rule 2002 (f) (7), for the Court's review and consideration.

20. This Order shall also. constitute the Bankruptcy Court's findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052.

/s/ James J Barta
JAMES J BARTA
U.S. Bankruptcy Judge

Copy mailed to:

Office of the United States Trustee
815 Olive Street, Suite 320-324
St. Louis, MO 63101

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8011 Clayton Road, Thrid Floor
St. Louis, MO 63117

APPENDIX C

GANNON
Gannon International, Ltd.

August 27, 2001

VIA FACSIMILE 901-755-6603
Mr. Kevin W. Kelly
2101 Merchants Row, Suite 2
Germantown, TN 38138

Re: West Pointe Limited Partnership
U. S. Bankruptcy Court for the Eastern District of Missouri
Chapter 11 Case Nos. 26-217, *et seq.*
Our Reference No. GPP01-2

Dear Kevin:

It was a pleasure talking to you on Friday.

Please be advised that if the former Debtors follow through on their threat to attempt to convert the bankruptcy case to a Chapter 7 liquidation at this point in time, the Settlement Agreement (an invitation to the former Debtors and the limited partners to make a settlement proposal to Gannon) forwarded under my cover of July 3, 2001 shall be immediately and irrevocably withdrawn. In that event, please understand, and make sure all of the limited partners understand, that there will be no further settlement discussions, of any kind.

Further, in the event that the former Debtors file such a conversion motion, we fully intend to move for sanctions against you individually, the former Debtors, and any attorney signing such a pleading. We understand that the Bankruptcy Code and related case law clearly preclude any good faith argument that such a motion is proper, at this point in time.

Please govern yourself accordingly.

Very truly yours,
/s/ Robert P. Greene
ROBERT P. GREENE

RPG:mh
cc: Terry L. Pabst, Esq.

APPENDIX D

CASTLE & ASSOCIATES, PLC
Attorneys and Counselors

319 Koger Center • 6555 Quince Road
MEMPHIS, TENNESSEE 38119
TELECOPIER (901) 755-4159
(901) 756-6100

F. GUTHRIE CASTLE, JR.

August 28, 2001

Mr. Terry Pabst, Esq.
11301 Olive Boulevard
St. Louis, MO 63141

VIA FAX

re: Bankruptey Court Case Nos.:
West Pointe Limited Partnership, No. 90-44326-172
Northwest Village Limited Partnership,
No. 90-44327-172
Grandview Hills Limited Partnership, No. 90-44328-172
Park Ridge Apartments Limited Partnership,
No. 90-44329-172
Lamplite Limited Partnership, No. 90-44330-172

Dear Terry:

Thank you for your letter of August 27. I was aware of the *Grinstead* case, however, I do not believe it supports your position, because its holding is limited to facts inapplicable to our case:

> Once a plan of reorganization is confirmed, the bankruptcy estate ceases to exist *unless the plan specifically provides otherwise*, and all estate property revests in the

> debtor *subject to the terms and conditions imposed by the plan.*

In re Grinstead, 75 B.R. 2, 3 (Bankr.D.Minn.1985).

As you are aware, the plan in this case requires that the estate is to be transferred by the Debtors-in-Possession to GP 19 rather than revesting in the Debtors. This transfer, however, is not mandated until the "Confirmation Date", when all appeals have become final, and the right to pursue appeals is specifically granted by the plan. As we know, the law of the case for this bankruptcy is that the plan at this time has not been substantially consummated because there remain many estate assets to be transferred. These facts make the *Grinstead* case inapposite.

A case more on point is *In re Reef Petroleum Corporation,* 99 B.R. 355 (Bankr.W.D.Mich. 1989), in which the case was converted over three years after confirmation of the Chapter 11 plan. Therein the court held when the plan is not completed prior to conversion, "upon conversion, the assets should be distributed according to Chapter 7." In the case *of Abbott v. Blackwelder Furniture Company of Statesville, Inc.*, 33 B.R. 399 (W.D.N.C. 1983), the court held that even after confirmation of the plan as long as a trustee has not been appointed, "Congress provided the Chapter 11 debtor with the absolute right to accomplish voluntary conversion to a Chapter 7 liquidation without Court approval."

I am not aware of any case law which prohibits conversion of a post-confirmation Chapter 11 if the estate has not yet been fully administered. In fact under section 1112(a), conversion appears to be an absolute right as long as the debtor is a debtor-in-possession. Extensive case law holds that a debtor is always the debtor-in-possession unless a trustee has been appointed under section 1104.

We would be happy to discuss any of this with you further. Also, I would be happy to entertain any further research you may have on the subject.

Very truly yours,
Castle & Associates, PLC

By: /s/ F. Guthrie Castle
F. GUTHRIE CASTLE, JR.

cc: Mr. Kevin Kelly

APPENDIX E

[Logo] THE PENTAD GROUP

PENTAD GROUP, INC.
PENTAD EQUITIES, INC.
PENTAD PROPERTIES, INC.
PENTAD MANAGEMENT, INC.
PENTAD REAL ESTATE INVESTMENTS, INC.
Member NASD and SIPC

2101 Merchant's Row Suite 2 • Germantown, TN 38138
• (901) 755-0014 Fax (901) 755-6603 •
pentad@bellsouth.net

August 30, 2001

Gannon Companies
Attn: Bob Greene
11301 Olive Blvd.
St. Louis, MO 63141

Fax & US Mail

Re: St. Louis Associates Limited Partnership

Dear Bob:

I am in receipt of your letter dated August 27, 2001. Thank you for your prompt response to our conversation last Friday.

I have enclosed a copy of Guthrie Castle's letter to Terry Pabst, though I would guess you would have discussed the matter with Terry by this point in time. Just in case you didn't get a copy of Guthrie's letter from Terry I thought I should insure that you received one in order to point out that it would seem clear to us that while you might not agree with our sides conclusions we certainly have a sound argument to present and any motion to ask for sanctions would seem unreasonable.

If you have any desire to resume discussions regarding terms of a settlement agreement, pursuant to the concepts presented by Guthrie to Troy, after you have more clearly researched the law, please contact me no later than Thursday, September 6,

2001. I believe if we are not in serious negotiations by that point we will find it difficult to complete the matter before time will require the matter be concluded. In fact, if we expect to get a deal done, you and Terry/Bill/Troy should probably plan to come to Memphis in the coming week so we are not interrupted in finalizing a deal.

Thank you for past courtesies. I have enjoyed trying to resolve these contentious matters with you.

Sincerely,

St Louis Associates Limited Partnership
By: Pentad Properties, Inc., It's Administrative General Partner

/s/ Kevin W. Kelly
KEVIN W. KELLY, President

c/c Guthrie Castle

APPENDIX F

[Logo] THE PENTAD GROUP

PENTAD GROUP, INC.
PENTAD EQUITIES, INC.
PENTAD PROPERTIES, INC.
PENTAD MANAGEMENT, INC.
PENTAD REAL ESTATE INVESTMENTS, INC.
Member NASD and SIPC

2101 Merchant's Row • Suite 2 • Germantown, TN 38138
• (901) 735-0014 Fax (901) 755-6603 •
pentad@bellsouth.net

September 7, 2001

Mr. Robert P. Greene
Executive Vice President
Gannon International, Ltd.
11301 Olive Boulevard
St. Louis, MO 63141

By Fax & U.S. Post

Re: Chapter 7
Settlement Discussion

Dear Bob:

Thank you for your letter of September 5th. I must take exception to one point you made in the 5th paragraph that our tax adviser, Steve Dunavant, suggested that your settlement proposal was fair and would result in significant tax benefits to our partners. In fact, while Mr. Dunavant did provide a structure for a possible settlement agreement he in fact indicated that he would advise his clients who were in the transaction not to participate, given the contribution levels that GP 19 was suggesting. Please recall our conversation where Steve compared the proposed agreement to a letter of credit and suggested that the amounts being suggested by GP 19 made no economic sense to any investor who had all or most of his passive loss carry-forwards and might make only

marginal sense to those investors who had used all their passive losses. I hope I have been clear in suggesting that there are an insufficient number of investors who have used all their passive losses to reach your minimum of $850,000, and consequently have suggested to you that it makes little or no sense for us to move forward on the term and conditions you have set out.

I would be pleased, as I suggested in my voice mail to you, to forward a marked up version of your draft settlement agreement. This marked up draft is the information that Guthrie spoke to Troy about and that both Guthrie (from Troy) and I (from you) understood held no interest on your part. As I suggested in my voice mail I didn't think it warranted further action on our part unless you had interest in the proposal.

I have reviewed Terry's letter to Guthrie and have spoken to both Guthrie who will formally answer Terry's letter and other investors/lawyers and must report that there is a strong feeling that Chapter 7 is the way to proceed unless a reasonable settlement can be achieved. The group believes that our legal position will prevail, particularly given a Barta decision on the right to convert, and failing that the BAP panel's likelihood of approval given the case law.

I would urge you to be certain of your position and be certain soon, because, as I understand the law once the conversion to Chapter 7 is accepted by a court, our decision to proceed with Chapter 7 is not reversible, and contrary to Terry's suggestion that the conversion does not revoke the plan, I would suggest that is not correct and that in all likelihood the trustee would control the entire matter, to include management, until the properties were disposed of by the trustee.

I would think that keeping most of the pie (80%) is better than the distinct possibility of losing the entire pie. I want to take this opportunity to thank you for being straight forward and

forbearing during this long and arduous process and also want to wish you all the best in the future.

Sincerely,

St. Louis Associates Limited Partnership
by: Pertatdi Properties, Inc.,
it's Administrative General Partner

/s/ Kevin W. Kelly
KEVIN W. KELLY, President

c/c Guthrie Castle